IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

NO. 77-204

NATIONAL ASSOCIATION OF COMMODITY OPTION DEALERS, a non-profit association, HOFMANN, KAVANAUGH COMMODITIES CORP., INC., as Successor In Interest to First Western Commodity Options, Inc. of Los Angeles, A. L. & T. TRADING, INC., CHARTERED SYSTEMS CORPORATION, CLEARY TRADING COMPANY, INC., FIRST COMMODITIES CORP. OF BOSTON, INC., INTERNATIONAL TRADING GROUP, LTD., LONDON FUTURES, LTD., AND WILLISTON CORPORATION,

Petitioners,

v.

THE COMMODITY FUTURES TRADING COMMISSION, WILLIAM T. BAGLEY, Chairman; COMMODITY FUTURES TRADING COMMISSION, JOHN B. RAINBOLT, II, Vice Chairman; COMMODITY FUTURES TRADING COMMISSION, GARY SEEVERS, Commissoner; COMMODITY FUTURES TRADING COMMISSION, READ P. DUNN, JR., Commissioner; COMMODITY FUTURES TRADING COMMISSION; and ROBERT L. MARTIN, Commissioner, COMMODITY FUTURES TRADING COMMISSION,

Respondents,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Now come the Petitioners, National Association of Commodity Option Dealers ["NASCOD"], Hofmann, Kavanaugh Commodities Corp., as successor in interest to

First Western Commodity Options, Inc., of Los Angeles, A.L. & T. Trading, Inc., Chartered Systems Corporation, Cleary Trading Company, Inc., First Commodity Corp. of Boston, International Trading Group, Ltd., London Options, Ltd., and Williston Corp., [hereinafter collectively referred to as "NASCOD Petitioners"], by Goldstein, Ahalt & Bennett, Chartered, their attorneys, and hereby respectfully petition the Court to issue a Writ of Certiorari to review the Judgment and Opinion of the United States Court of Appeals for the Second Circuit ["Court of Appeals"] entered in this proceeding on April 4, 1977, and amended on May 11, 1977.

OPINIONS BELOW

The opinion of the Court of Appeals, as amended, which appears as Appendix A hereto is officially reported in 522 F.2d 482 (2nd Cir., 1977), and is unofficially reported in CCH Commodity Futures Law Reporter, ¶20400. On April 18, 1977, NASCOD Petitioners filed a timely Petition for Rehearing which was denied by Order dated June 6, 1977, a copy of which appears as Appendix B hereto. The Opinion of the United States District Court for the Southern District of New York ["District Court"] has not been officially reported. The Opinion has been unofficially reported at CCH Commodity Futures Law Reporter, ¶20245 and appears as Appendix C hereto.

JURISDICTION

The Judgment of the Court of Appeals was entered on April 4, 1977. A timely Petition for Rehearing was filed on April 18, 1977, and was denied by the Court of Appeals on June 6, 1977. This Petition for Certiorari was filed within ninety (90) days of the denial of the timely Petition for

Rehearing. This Court's jurisdiction is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Did the defendants Commodity Futures Trading Commission and individual members thereof ("Commission") act arbitrarily and capriciously in imposing Regulation 32.6 17 C.F.R. 32.6 (1976) when;

a. The segregation imposed by the Regulation fails to achieve the customer protection for which it was intended; to wit to preserve a fund for an option customer to draw upon in the event of the dealer's insolvency; and

b. The putative protective effect of the Regulation would conflict with the Bankruptcy Act; and

c. The Commission imposed a Regulation which will have the effect of putting NASCOD Petitioner firms out of business, in contravention of the Congressional mandate to consider the policies of the antitrust laws *and* to endeavor to take the least anticompetitive course of action; and

d. The Regulation lacks comprehensible standards to delineate how long funds must remain in segregation; and

e. The Commission has been unable to state a purpose for the Regulation which bears up under logical scrutiny.

2. Did the Court of Appeals depart from the principles set down by this Court and from the accepted and usual course of judicial proceedings by reversing a Preliminary

Injunction against the enforcement of Regulation 32.6, 17 C.F.R. 32.6 (1976) and granting summary judgment in favor of the Commission when:

a. The Court of Appeals did not determine that the District Court had abused its discretion in granting the Preliminary Injunction but only that it had "erred"; and

b. The Court of Appeals did not determine that the factual findings underlying the District Court's grant of the Preliminary Injunction were "clearly erroneous," but rather substituted the factual contentions made by the Commission without comment or analysis; and

c. The Court of Appeals aborted a proper judicial determination of the merits of this action by granting a premature summary judgment, thus depriving the NASCOD petitioners of the opportunity to prove that the action of the Commission in promulgating Regulation 32.6, 17 C.F.R. 32.6 was "unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing Court," as set forth in Section 10(e)(2)(F) of the Administrative Procedure Act, 5 U.S.C. §706(2)(F); and

d. The Court of Appeals, by granting a premature summary judgment, deprived the NASCOD Petitioners of an opportunity to conduct meaningful discovery and to present evidence that the promulgation by the Commission of Regulation 32.6, 17 C.F.R. 32.6 (1976) was arbitrary, capricious, unwarranted, and unjustified.

REGULATORY AND STATUTORY PROVISIONS INVOLVED

1. Commission Regulation 32.6, 17 C.F.R., Section 32.6 (1976), which appears as Appendix D hereto.

2. Section 4(c)(b) of the Commodity Exchange Act, as amended by the Commodity Futures Trading Commission Act of 1974, 7 U.S.C., Section 6(c)(b)(Supp. V, 1975), which appears as Appendix E hereto.

3. Section 15 of the Commodity Exchange Act, as amended by the Commodity Futures Trading Commission Act of 1974, 7 U.S.C., Section 19 (Supp. V, 1975), which appears as Appendix F hereto.

4. Section 10(e) of the Administrative Procedure Act, 5 U.S.C., Section 706 (1970), which appears as Appendix G hereto.

STATEMENT OF THE CASE

A. *The Commodity Options Industry*

Petitioner NASCOD is an unincorporated trade association comprised of member firms, including the individual NASCOD Petitioners hereto, who are in the business of dealing in options of certain commodities. Trading in commodity options is subject to regulation by the Commission pursuant to Sections 2 and 4(c)(b) of the Commodity Exchange Act, as amended by the Commodity Futures Trading Commission Act of 1974 [hereinafter "the Act"], 7 U.S.C., Section 2 and 6(c)(b)(Supp. V, 1975).

On October 23, 1974, Congress enacted the Commodity Futures Trading Commission Act of 1974 , 88 Stat. 1389. This Act constituted a series of amendments to the Commodity Exchange Act, 7 U.S.C. §1-17b (1970) and established the Commission as an independent federal regulatory agency, and referred to it certain regulatory functions previously within the jurisdiction of the Department of Agriculture.

The commodities industry operates as a market place of contracts, for the purchase, or sale, of specific amounts of the commodity, either that have already been produced, or that will be produced at some point in the future and delivered by a specific date. A "commodity option" is a contractual right to buy, or sell, a commodity or commodity future by some specific date at a specified, fixed price, known as the "striking price." The NASCOD Petitioner firms all deal in "London Options," which are options on futures contracts for certain commodities traded in London, England on either the London Metal Exchange (L.M.E.), or the International Commodity Clearing House (ICCH) [sometimes hereinafter collectively referred to as the "London Exchanges"].NASCOD Petitioner firms receive orders from the public and institutions and solicit the public and institutions for potential customers. When a customer orders an option, he makes a cash payment to the NASCOD Petitioner firm. This payment includes the firm's commission for its services in obtaining the option ordered by the customer and the price the grantor or writer of the option charges for the option, known as the "premium." Once the dealer receives the cash payment, he executes the trade through a "clearing member" of one of the London Exchanges. There are a number of American firms who are clearing members, and the NASCOD Petitioner firm may deal either through one of these, as is the usual case, or through an English clearing member firm. The NASCOD

- Petitioner firms forward the premium amounts to the clearing member firms from where they pass through the clearing house processes of the London Exchanges. The London Exchanges record the option in the name of the clearing member firm, who in turn advises the NASCOD Petitioner firm of the purchase of the option on behalf of the customer. The London Exchanges furthermore guarantee performance to the clearing member firm. To the knowledge of the NASCOD Petitioners, there has not been a default on the London Exchanges in nearly 200 years. To profit, the customer must exercise the option before it expires, by purchasing the underlying futures contract at the striking price, at a time when the market price of the underlying contract has risen sufficiently to allow the customer to recover more than his gross payment for the option. Upon instruction from the NASCOD Petitioner firm, the clearing member firm generally exercises the option, obtains the underlying futures contract at the striking price, sells it at the market price, and forwards the profit to the NASCOD Petitioner firm who in turn conveys it to the customer. The difference between the price at which the option is exercised plus the commission paid for the option by the customer and the price at which the futures contract is sold is the customer's profit. If the price of the underlying futures contract drops and remains below the striking price, the customer allows the option to lapse without exercise.

Once the option has been purchased, the customer is not subject to further margin calls as is an investor in conventional commodities or futures contracts, and, therefore he can lose no more than his original investment. This makes options an attractive and low cost form of investment for investors who do not have sufficient capital or sophistication to participate in commodity futures.

B. *Regulation of the Options Industry and Promulgation of Regulation 32.6, 17 C.F.R. 32.6 (1976).*

The Commodity Futures Trading Commission Act of 1974 gave the Commission "exclusive jurisdiction" to regulate commodity options. Section 2(a)(1) of the Act, 7 U.S.C. §2 (Supp. V, 1975). Prior thereto, the Commodity Exchange Act had banned options in certain agricultural commodities, 7 U.S.C. §6c (1970), although trading in options other than for these specific commodities continued without regulation. The new Act continued the prior ban, Section 4c(a), 7 U.S.C., §6c(a), but permitted options on other commodities to be written and traded pursuant to whatever reasonable regulations the Commission might promulgate. Section 4c(b) of the Act; 7 U.S.C. §6c(b).

Congress determined that the regulatory gap be closed because of various fraudulent schemes in the late 1960's and early 1970's involving unregulated options, the most serious of which was the Goldstein, Samuelson matter. This fraudulent scheme involved the sale of so-called "naked options;" that is, options which, unlike the options at issue here, were not supported by underlying futures contracts. *Hearings on S. 2485, S. 2587, S. 2837 and H.R. 13113 before the Senate Committee on Agriculture and Forestry, 93rd Cong.*, 2nd Sess., p. 3 at §24-825 (1974).

On April 25, 1975, just four (4) days after it came into existence, the Commission proposed an anti-fraud rule in connection with transactions in options, solicited comments thereupon, 40 Fed. Reg. 18, 187 (April 25, 1975), and thereafter adopted the rule. 40 Fed. Reg. 26,504 (June 24, 1975).

On October 22, 1975, the Commission published notice that it was "considering the adoption of further rules to regulate – or perhaps forbid – transactions in commodity options." 40 Fed. Reg. 49360. The Commission appointed an Advisory Committee to recommend a system of regulations for the options industry, 40 Fed. Reg. 49360. On February 20, 1976, the Commission published a proposed set of options regulations, prior to receiving the report of the Advisory Committee. 41 Fed. Reg. 7774 (1976). These proposed requirements included registration of options dealers with the Commission as futures commission merchants, a One Hundred Thousand Dollar ($100,000.00) capital requirement for futures commission merchants dealing in options and provisions for disclosure to customers and for record keeping. However, there was no segregation proposed, although the Commission did indicate it was "particularly interested" in comments on the wisdom of imposing such a requirement. 41 Fed. Reg. 7776 (1976). On March 8, 1976, the Commission held a public hearing on the proposed regulations, and on July 6, 1976, received the report of the Advisory Committee. CCH Commodity Futures Law Report No. 26, Extra Edition, July 15, 1976. The Advisory Report generally supported a segregation requirement, subject to certain qualifications to be discussed *infra* at page 27. On October 8, 1976, the Commission published a second set of proposed interim regulations which were intended to become effective on November 22, 1975 and solicited comments from the public before November 8, 1975. 41 Fed. Reg. 44560, *et seq.* For the first time, the Commission specifically proposed a segregation requirement. Its proposed Regulation 32.6 required a registered futures commission merchant to segregate one hundred percent (100%) of the funds received from customers in special bank accounts in the United States until the option was either exercised or "all rights of the

option customer under the commodity option have been fulfilled." 41 Fed. Reg. 44567. In the October 8, 1976 Federal Register Notice setting forth the proposed regulation, the Commission expressed its awareness of the deleterious effect of the proposed regulation on firms such as NASCOD Petitioners who must submit premiums received immediately through their clearing member firms to the London Exchanges to purchase options to satisfy orders of customers:

> As noted above, the Commission is aware that proposed §32.6 may in certain cases, require "double segregation." For example, in the case of the sale of London options, a person receiving the funds from an option customer in the United States as payment for the option may not remit those funds to London in order to obtain or maintain the option position with a London broker. The Commission believes that the proposed segregation requirements are an essential customer protection to be afforded commodity option customers in the United States. The Commission recognizes, however, that its proposed segregation requirements may impose a financial hardship on some affected persons, and as noted in more detail below, requests specific comments on these requirements, particularly alternatives which could provide substantially equivalent customer protections. 41 Fed. Reg. 44562.

On November 24, 1976 the Commission adopted its final regulations in substantially the same form it had proposed on October 8, 1976, to take effect in fifteen (15) days except for the segregation requirements of Regulation 32.6, which was to become effective thirty (30) days thereafter. 41 Fed. Reg. 51808 *et seq.* The November 24, 1976 Federal Register Notice re-published the October 8, 1976 Federal Register Notice as an appendix thereto. 41 Fed. Reg. 51808. The final Regulation 32.6 was virtually identical with its October 8,

1976 predecessor, except that it required futures commission merchants dealing in options to segregate ninety percent (90%) of the funds received from customers rather than the original one hundred percent (100%). According to the Federal Register Notice, this reduction was "to help meet operating expenses or the costs of any necessary financing arrangements," 41 Fed. Reg. 51812. The Notice never discusses how the figure of a ten percent (10%) reduction was calculated and determined, other than by administrative fiat. The November 24, 1976 Federal Register Notice stated that "the strongest objections made to the Commission's proposed interim rules concerned the segregation requirements of §32.6," and reiterated the statement made in the October 8, 1976 Notice that the regulation would result in "double segregation" for dealers in London options. 41 Fed. Reg. 51812.. [The regulatory requirement imposed by Regulation 32.6, 17 C.F.R. 32.6 (1976) will hereinafter sometimes be referred to as "double segregation."]

The other new regulations prohibited a firm from selling options after January 17, 1977, unless the firm was registered with the Commission as a future commission merchant. Regulation 32.3 17 C.F.R. 32.3 (1976). To be registered, a futures commission merchant dealing in options must maintain an adjusted working capital of a greater sum than Fifty Thousand Dollars ($50,000.00) or a formula figure, one of whose components is five percent (5%) of the firm's aggregate indebtedness. Regulation 1.17, 17 C.F.R., Section 1.17 (1976). Regulation 32.5, 17 C.F.R., Section 32.5 (1976) required certain disclosures to be made to options customers, including the furnishing of a summary disclosure statement prior to the purchase of an option, and an explanatory confirmation notice afterwards. Another regulation required firms to keep lists of customers who purchased options as well as members of the public merely solicited and to make these lists available to the Commission on request. Regulation

32.7, 17 C.F.R., Section 32.7 (1976). This litigation was filed thereafter to obtain judicial pre-enforcement review of these regulations.

C. Prior Court Proceedings.

NASCOD Petitioners originally filed their action to enjoin the aforementioned regulations in the United States Court for the District of Columbia, No. 76 Civil 2250, on December 8, 1976. The action was transferred by order dated December 14, 1976 to the United States District Court for the Southern District of New York and consolidated with *British American Commodity Options Corporation and Company v. Bagley*, No. 76 Civil 5124 unbeknownst to NASCOD Petitioners. That case concerned identical issues, and had been filed several days prior to this action by British American Commodity Options Corporation and Lloyd, Carr and Company. District Court jurisdiction in the consolidated action was premised on 5 U.S.C., Section 701 *et seq.*,; 7 U.S.C. Section 3; 28 U.S.C. Section 1331; 28 U.S.C. Section 1337; and 28 U.S.C. Sections 2201 and 2202.

NASCOD Petitioners had been seeking a preliminary injunction at the time of the consolidation, as had the plaintiffs in the consolidated action. The defendant Commission had simultaneously moved for summary judgment in the *British American* action, and this cross-motion was considered by the District Court to apply to the NASCOD Petitioners. On December 21, 1976, after lengthy argument and consideration of the evidentiary material presented, the Honorable Judge Whitman Knapp preliminarily enjoined the Commission from enforcing Regulation 32.6, 17 C.F.R. 32.6 (1976) against "any plaintiff who was in the business of selling options as an agent," but granted the Commission's motion for summary judgment as to the other challenged

regulations. With respect to Regulation 32.6, 17 C.F.R. 32.6 (1976), Judge Knapp indicated that the plaintiffs had a reasonable likelihood of establishing that the Commission had acted arbitrarily and capriciously in establishing the "admittedly harsh" requirement. In so doing, the court held:

> "... it is our conclusion of fact that plaintiffs are threatened with irreparable injury in that, being required by the necessities of their business to forward to their principals in London the premiums for options they sell to their customers (representing at least 75% of the funds received from customers, they could not long remain in business if required to segregate in the United States an amount equal to 90% of such funds [footnote reference omitted]. It is our conclusion of law that – for the reasons above outlined – plaintiffs have a reasonable likelihood of success on the merits of their attack on the segregation requirement. We further conclude, in light of the wide panoply of regulations already and about to be in effect, that the public interest will not be adversely affected by preliminarily enjoining these segregation requirements."

The parties took cross appeals from the decision of the District Court, which the Court of Appeals agreed to expedite. The NASCOD Petitioners appealed from the granting of a summary judgment as to the other challenged regulations, while the Commission cross appealed from the preliminary injunction. On April 4, 1977, the Court of Appeals issued a Judgment and Opinion affirming the District Court's grant of summary judgment on the challenged regulations, but reversing the preliminary injunction. This Judgment and Opinion was amended in certain non-material respects by an Order dated May 11, 1977.

In reversing the preliminary injunction, the Court of Appeals stated;

> "We conclude, therefore that the Commission's desire to impose a segregation requirement was a reasonable exercise of its discretion in an effort to protect the public, and that the Commission's analysis of the problem and alternative solutions was adequately deliberate. We hold that the district judge erred in granting plaintiffs a preliminary injunction against the segregation requirement." 552 F2d at 490-491.

The tenor of the Court of Appeals' Opinion and the absence of any indication to the contrary leads to the conclusion that the Court of Appeals granted summary judgment as to Regulation 32.6, 17 C.F.R. 32.6 (1976). Therefore, this Court has a final Judgment and Opinion of the Court of Appeals to review, rather than merely an interlocutory order. On June 6, 1977, the Court of Appeals denied NASCOD Petitioners' Petition for Rehearing, without comment.

REASONS FOR GRANTING THE WRIT

A.

THIS CASE INVOLVES IMPORTANT FEDERAL QUESTIONS OF FIRST IMPRESSION WHICH SHOULD BE DECIDED BY THIS COURT.

The Commodity Futures market is a major industry in the United States, far exceeding the volume of the securities industry. Its annual volume has been estimated as high as Five Hundred Billion Dollars ($500,000,000,000.00). Although the options industry is much smaller, the NASCOD Petitioners

have estimated that they have a combined annual sales volume of more than Forty-One Million Dollars ($41,000,000.00) and they employ hundreds of people. This business enterprise is now threatened by the enforcement of "double segregation," as the District Court specifically found.

This case then does not represent merely an academic disagreement over some arcane regulation. Rather, the ability of the NASCOD Petitioner firms to continue in business is at stake here. This case marks the first occasion to the knowledge of NASCOD Petitioners that the actions of the new Commission have been before this Court. The Commission is a newly established independent federal regulatory agency. The Court of Appeals in its Opinion specifically noted that "both [the] system of rules and the agency itself are newly created." 552 F.2d at 488. Because of the confiscatory nature of the regulation in question, this case represents the confluence of the question of the survival of an industry with the first judicial test of the regulations promulgated by a major new agency. It is accordingly a federal matter of first impression which is of the utmost importance to NASCOD Petitioners, the Commission, and the investment community.

This case is also an important federal matter of first impression in that there is no analogy in any other field of industry or commerce to the "double segregation" requirements of Regulation 32.6, 17 C.F.R. 32.6 (1976). In no other enterprise must a customer's funds be retained after he has received the full benefit of his bargain; *i.e.*, the option has been purchased for him as promised. A business, of course, must be able to continually reinvest its capital to meet expenses, to purchase inventory, and to expand. The "double segregation" provision is equivalent to forcing a car dealer to pay General Motors from his own funds when a customer orders an automobile and not be able to use the proceeds

received from the customer for any purpose whatsoever until such time as the warranty on the car expires a year or more later. Certainly the authority of a federal agency to propose so sweeping and novel a regulation is a federal question of first impression which should be decided by this Honorable Court.

B.

THE ISSUE OF THE LAWFULNESS OF REGULATION 32.6, 17 C.F.R. 32.6 (1976) HAS SPAWNED OTHER LITIGATION, AND IT IS THEREFORE A MATTER WHICH SHOULD BE DECIDED BY THIS COURT.

The issue of the lawfulness of "double segregation" has spawned a multiplicity of litigation in the federal courts. This consolidated action is the product of only the first two such actions.

On or about April 25, 1977, another member firm of Petitioner NASCOD filed an independent action to enjoin the enforcement of Regulation 32.6, 17 C.F.R. 32.6 (1976). *Frankland Commodities Corporation v. Commodity Futures Trading Commission, et al.*, N.D. Ga., Atlanta Division, Civil Action No. C-77-643A. There, Judge Charles A. Moye, Jr., in an Opinion dated May 12, 1977, a copy of which appears as Appendix H hereto, refused to preliminarily enjoin the Regulation on the grounds that the plaintiff had not made a sufficient showing of irreparable injury. However, the Court did state that it was "not entirely persuaded by the Opinion of the Second Circuit" and that the plaintiff had presented a "substantial cause of action." The Court granted an injunction pending an appeal of the denial of the preliminary injunction to the United States Court of Appeals for the Fifth Circuit in a separate Order dated May 12, 1977, a copy of which appears as Appendix I hereto.

Recently, another options firm filed an action in the United States District Court for the Southern District of New York to enjoin operation of the Regulation. *Neuberger Securities Corporation v. Commodity Futures Trading Commission, et al.*, 77 Civil 3048. On July 7, 1977, Judge Charles L. Brieant signed an Order enjoining the Commission from enforcing Regulation 32.6, 17 C.F.R. 32.6 (1976) against Neuberger Securities Corporation, pending further developments in this proceeding. A copy of that Order appears as Appendix J hereto. On information and belief, other firms are now contemplating similar action in other circuits, so that they too might have the benefit of court protection from "double segregation" pending a final determination of this issue by this Honorable Court. NASCOD petitioners will undertake to inform the Court by supplementary Petition of any developments in *Frankland Commodities v. CFTC, supra.*, or any other pending actions.

While, of course, these other actions do not constitute a split of authority in the circuits within the meaning of Supreme Court Rule 19b, the multiplicity of litigation clearly demonstrates both the importance of the question involved, and that the decision of the Court of Appeals may be incorrect, which militates in favor of issuance of the Writ of Certiorari sought here. Cf. *Shapiro v. United States*, 335 U.S. 1, 4 (1974).

C.

THIS CASE INVOLVES AN IMPORTANT FEDERAL QUESTION CONCERNING THE CONSTRUCTION OF THE ACT, AND ITS RELATIONSHIP WITH THE ANTITRUST LAWS.

The novel and important question of the interrelationship and construction of the Act with the

antitrust laws is encompassed within the prevailing general issue of the lawfulness of Regulation 32.6, 17 C.F.R. 32.6 (1976). In passing the Commodity Futures Trading Commission Act of 1974, Congress was careful to include provisions which required the Commission to be ever vigilant and mindful of the antitrust laws;

> "The Commission shall take into consideration the public interest to be protected by the anti-trust laws and *endeavor to take the least anticompetive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation . . .* " [emphasis supplied] Section 15 of the Act, 7 U.S.C., Section 19 (Supp. V., 1975).

The NASCOD Petitioners maintain that the plain language of Section 15 imposes two separate duties in the Commission. First, the Commission must consider and evaluate the antitrust aspects of any proposed action in a meaningful fashion. Second, it must make an actual effort to choose the least anti-competitive alternative. Here the Commission breached both of these statutory duties in that it imposed a regulation which will have the most anti-competitive effects: putting the option specialty houses out of business, and making commodity options a monopoly of a few large, diversified securities and commodities firms who have sufficient cash flow from sales of other investment vehicles to surmount "double segregation". The Commission did not take into proper account the public interest to be served by the antitrust laws, nor did it seriously endeavor "to take the least anti-competitive means."

The November 24, 1976 Federal Register Notice states:

> Section 15 requires that the Commission take into consideration the public interest to be

> protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives, policies and purposes of the Act. While the Commission is mindful that the financial, segregation and other criteria imposed as prerequisites to allowing a person to enter into or continue in the commodity options business may result in some lessening of competition, in its judgment, the interim rules are necessary to effectuate an essential purpose and policy of the Act: That is to require that the Commission provide essential customer protections which would attempt to assure the financial solvency of option transactions and prevent fraud. As a result, rules have been adopted, particularly in the areas of registration, disclosure, segregation and minimum working capital, which are intended to provide such customer protections as are deemed essential. Such rules may have an anticompetitive effect in that not all persons will be able to comply because of lack of adequate financing or other reasons. Nonetheless, in weighing its responsibilities, the Commission has determined that the objectives, policies and purposes of the Act can be met, in its judgment, only by regulations such as these. 41 Fed. Reg. 51809.

The District Court accepted this untested, conclusory statement as a discharge of the Commission's duties under Section 15 of the Act, while the Court of Appeals never even considered the issue of the Commission's compliance with the Section. The record is devoid of any real evidence that the Commission evaluated the anti-competitive effects of Regulation 32.6, 17 C.F.R. 32.6 (1976), or that it considered less anti-competitive alternatives. Relying solely on the record it would appear that "double segregation" was the first and only solution ever considered by the Commission. In *Sabin v. Butts,* 515 F.2d 1061 (10th Cir., 1975), the Court of Appeals reversed a grant of summary judgment in favor of the

Department of Agriculture on the ground that the record did not show evidence of consideration of anti-trust factors. 515 F.2d at 1069.

This Honorable Court now has an opportunity to define the duty Section 15 imposes upon the Commission. To allow the Commission to evade its duty under Section 15 by publishing an untested, self-serving statement is to render the Congressional mandate memorialized in that Section a nullity. The Court should rule that the Section imposes affirmative duties on the Commission to consider antitrust factors, and choose the least anti-competitive course and the NASCOD Petitioners should be able to conduct a searching inquiry into whether the Commission fulfilled these duties. This is especially true in a case like the one at bar, where the action of the agency is *prima facie* anti-competitive. This Honorable Court should rule that great weight and effort should be given to Congress's extraordinary requirement of forcing this new agency to give consideration to the anti-competitive aspects of its Regulation, and should grant a Writ of Certiorari to consider the question of the duties imposed by Section 15 of the Act.

D.

THERE IS AN IMPORTANT FEDERAL QUESTION AS TO WHETHER FEDERAL REGULATION 32.6, 17 C.F.R. 32.6 (1976) HAS A REASONABLE BASIS AND A RATIONAL NEXUS TO THE WRONGS IT IS SUPPOSED TO REMEDY. THE COURT OF APPEALS DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS BY UPHOLDING A PATENTLY UNREASONABLE REGULATION.

This Honorable Court should grant a Writ of Certiorari to determine the important federal question of whether Regulation 32.6, 17 C.F.R. 32.6 (1976) violates NASCOD Petitioners' rights to substantive due process of law and equal protection of the laws, and further violates Section 10(e)(2)(A), (B) and (C) of the Administrative Procedure Act, 5 U.S.C. Section 706 (2)(A), (B) and (C) in that it has no rational basis or reasonable nexus to the wrongs it is intended to prevent or remedy. The Court of Appeals' summary affirmance of "double segregation" is a departure from the accepted and usual course of judicial proceedings.

In reviewing agency action, a Court must conduct a searching and careful inquiry into the proceeding, and the agency has the burden of articulating a rational connection between the facts which it found and the administrative choices which it made. *Bowman Transportation, Inc. v. Arkansas Best Freight Systems, Inc.*, 419 U.S. 281, 285-286 (1974). Judged by this standard, "double segregation" must fail, as it has no rational basis, nor can it perform the functions for which it is intended.

The underlying rationale of the Regulation is that it is the minimum customer protection device required under the circumstances. In the November 24, 1976 Federal Register Notice, the Commission stated:

> "The Commission firmly believes that by providing a minimum fund under segregation requirements, an essential customer protection, *albeit a bare minimum one*, will be afforded commodity option customers in the United States." [emphasis supplied] 41 Fed. Reg. at 51812.

The Court of Appeals accepted this characterization without question:

> "The Commission's conclusion that in light of past abuses, the public now needs this *minimal protection* carries great weight." [emphasis supplied] 552 F2d at 490.

The characterization of "double segregation" as "minimal" is a complete misreading of the Regulation. Regulation 32.6 17 C.F.R. 32.6 (1976) is not minimal, but rather, it is a requirement which may well have a highly deleterious effect upon NASCOD Petitioner firms, as the Commission itself, noted in both Federal Register Notices.

The record of this proceeding fails to demonstrate how "double segregation" will protect option customers so as to justify its draconian effect upon NASCOD Petitioner firms. In the October 8, 1976 Federal Register Notice, the Commission attempted to justify double segregation as a customer protective device by stating:

> "In the Commission's view, these segregation requirements are a cardinal tenet of commodities regulation, and will help to prevent fraud. Absent segregation, these assets could be used by a person in its general operations. In addition, absent segregation, these assets might be subject to the claim of general creditors of the person accepting them." 41 Fed. Reg.44564.

The Court of Appeals apparently accepted this rationale without further inquiry;

> "In the absence of such protection, a need for capital might prod a dealer into over-dependence on customers' money to finance general operations." 552 F2d at 489-490.

Such an argument reveals a lack of understanding of the mechanics of the options industry. As discussed heretofore, in the absence of "double segregation," the greatest part of customers' funds are immediately transferred to the clearing member firm, and to the London Exchanges. It is therefore impossible for a futures commission merchant to use customers' payments for the option premium to finance its overall operation. Viewed most cynically, an unscrupulous operator would find it far easier to divert and misappropriate assets which are being built up into large amounts kept in the United States, than to embezzle monies which must be forwarded immediately. Petitioner NASCOD firms simply do not have long-term access to or control of customer funds, and it is therefore impossible for a firm to use the money to finance general operations as the Court of Appeals and the Commission fear. Even assuming *arguendo* the firm did enjoy such control of funds, once the customer has received his option, he has received the benefit of his bargain. There is no reason why the NASCOD Petitioner firm should *not* be able to use the proceeds from sales, like any other retailer can.

As the District Court expressly found, the worthy goal of customer protection is adequately served by the panoply of other regulations now wielded by the Commission which do not impose the hardship of "double segregation." Thus, NASCOD Petitioner firms must register with the Commission as futures commission merchants. Regulation 32.3, 17 C.F.R. 32.3 (1976). As such, NASCOD Petitioner firms must maintain net capital which is the greater of Fifty Thousand Dollars ($50,000.00) or a formula considering safety factors, which is five (5) times the net capital required for futures commission merchants who sell only conventional commodity futures. (Regulation 1.17, 17 C.F.R. 1.17 (1976)). As registered futures commissions merchants, NASCOD Petitioner firms must provide all options customers with a summary disclosure statement

prior to the actual purchase of an option, and with a confirmation notice making certain other required disclosures. Regulation 32.5, 17 C.F.R. 32.5 (1976). Additionally, all NASCOD Petitioner firms are required to return books and records for Commission inspection, even including lists of solicited members of the public who did not purchase options. Regulation 32.7, 17 C.F.R. (1976). Finally, NASCOD Petitioner firms are subject to a strict regulation prosecuting fraud in connection with transactions in options. Regulation 32.9, 17 C.F.R. 32.9 (1976). If a NASCOD Petitioner firm does not comply with even one of these regulations, its registration may be suspended or revoked by the Commission, and it may be assessed a One Hundred Thousand Dollar ($100,000.00) civil penalty, pursuant to Section 6(b) and 8(a)(3) of the Act, 7 U.S.C., Section 9 and 12(a)(2).

Although the Court of Appeals noted that the "double segregation" requirement was justified in view of "past abuses," neither the Court of Appeals nor the Commission has been able to articulate what these "past abuses" were or how, if at all, the "double segregation" requirement could have prevented them. The only cases of "past abuses" cited by the Court of Appeals in its opinion are two (2) Securities and Exchange Commission matters; *SEC v. Continental Commodities Corporation*, 497 F.2d 516 (5th Cir., 1974) and *SEC v. Univest Inc.*, 405 F. Supp. 1057 (N.D. Ill., 1976). footnote 11, 552 F2d at 489. These cases involve factual situations which occurred prior to the time period during which the Commission has regulated the commodities or the options industry and were brought under the federal securities laws. As was discussed *supra*, the more celebrated "past abuses" involving commodity options were the fraudulent schemes involving sales of "naked options" which have absolutely no rational connection to the highly regulated, ethical operations of Petitioner NASCOD firms. Fraudulent sales practices may involve any kind of enterprise, such as oil drilling, "industrial wines," scotch

whiskey, Florida land, or used cars and are not generic to commodity options. Once again, the record entirely fails to support the harsh administrative choice made.

"Double segregation" is entirely unworkable as an anti-fraud rule. The Commission is unable to indicate one kind of fraud or defalcation which can be cured or remedied by the drastic medicine of "double segregation." Furthermore, the Commission enjoys a well-tailored anti-fraud rule, 17 C.F.R. 32.9 (1976), which fully protects the public, while imposing no concomitant burden or discomfort upon NASCOD Petitioner firms.

Yet another Commission justification for Regulation 32.6, 17 C.F.R. 32.6 (1976), is that "double segregation" protects American customers from untoward occurrences on the London Exchanges. In its Opinion, the Court of Appeals accepted this contention at face value:

> "The Commission looked warily at safeguards allegedly implemented abroad, noting that 'assets [segregated in the United States] would not be subject to the attachment of other laws or requirements of any other nation.' 41 Fed. Reg. 44564 (1976). Evidence from the record raises serious questions about whether the English safeguards would effectively protect the American customer." 552 F.2d at 489.

There is no evidence in the record of this proceeding of any failure to perform on an options contract by either of the London Exchanges. Furthermore, since the commencement of this litigation, the Commission has learned that American investors do not require extraordinary protection from unknown dangers in London. In its proposed new interim option regulations, published in the Federal Register on April 5, 1977, the Commission has stated:

> "Wrongful acts in the United States in connection with London options appear to have been perpetrated exclusively by sales persons or organizations here and not abroad. No fraudulent or

> other wrongful activity that has worked to the detriment of option customers in the United States has apparently been attributed to any act or omission of foreign boards of trade themselves. For these reasons the Commission has some confidence in their integrity and in the ability of these markets meaningfully to police their own numbers and proposes to focus its attention on the offerers and sellers of London options in the United States rather than on the London exchanges. But nevertheless, the Commission intends to impose certain minimal requirements on foreign boards of trade intending to be recognized as foreign commodity option exchanges." 42 Fed. Reg. 18249 (1977).

Similarly, the Commission has also argued that "double segregation" is necessary to protect a customer in the event of the insolvency of the futures commission merchant. The Federal Register Notice of November 24, 1976 states that "double segregation" assures the customer that the assets he puts up to purchase a commodity option:

> "will be safe during the term of the option, and will be available to be refunded in the event that an option customer exercises the option but is unable to obtain satisfaction of the obligations owing to him because of the insolvency of his futures commission merchant or its principals." 41 Fed. Reg. 51812.

"Double segregation" would be ineffectual for the purpose intended in the event of the insolvency of a futures commission merchant like a NASCOD Petitioner firm. The investor who would have received his option would have no claim on the segregated funds. These funds would be part of the bankrupt's estate, as they do not enjoy a statutory exemption from such inclusion. Bankruptcy Act, Section 70, 11 U.S.C., Section 110. An investor who had not yet received

his option would at best be in the lowly position of an unsecured creditor of the futures commission merchant. Even the July Advisory Committee Report, which recommended "double segregation," noted that the device might not protect investors in the event of the insolvency of the dealer. That Report states at page 48:

> "The Advisory Committee understand that the legal efficacy of segregation imposed by regulation is uncertain. . . . [T][he Advisory Committee recommends that the Commission seek appropriate legislation to assure that full recognition be given under the bankruptcy laws to assets segregated for the benefit of customers pursuant to Commission requirements."

There is no evidence that such "appropriate legislation" has been passed by Congress. In fact, this has not been done and the bankruptcy laws which conflict with this portion of the regulations would take precedence. The Commission argued in the District Court that this issue should be left to a decision by a bankruptcy court in the event of an insolvency, but this is falacious reasoning. The District Court rejected this contention and made the determination that "double segregation" was inefficacious in light of the bankruptcy laws and therefore was arbitrary and capricious since it could not accomplish the purpose intended. Therefore, "double segregation" cannot give a customer rights under the Bankruptcy Act, he does not otherwise have, and will be of no value to a customer in the event of the insolvency of a futures commission merchant. Moreover, if the Commission were genuinely concerned with the prospect of insolvencies by registered futures commission merchants, it would not impose "double segregation" which can only be met, at all, by massive long-term borrowing. Such enforced borrowing can only make the specter of insolvency a self-fulfilling prophecy.

"Double segregation" would similarly be worthless to a customer in the event of the insolvency of a "principal" of his futures commission merchant. The term "principals of the futures commission merchant" can refer only to the London Exchanges or to the clearing member firms. There is no rational basis for any fear of insolvency on the London Exchanges, in that they have had a record of nearly two hundred (200) years of safe operations. Furthermore, the clearing member firms are also registered futures commission merchants, and are therefore subject to full Commission regulations. Moreover, the clearing member firms only serve as conduits for customers' funds, and do not retain or hold them, so the danger that such an insolvency might injure an options customer is at best highly remote.

The Court of Appeals incorrectly tried to retroactively justify "double segregation" as an adjunct to the Commission's net capital requirement;

> "Moreover, stringent controls on the use of customers' money are particularly sensible in an industry, such as commodity options trading, that attracts some thinly capitalized firms."
>
> * * * * * * *
>
> And in any event, the requirement is not unreasonable even if it threatens to restrict participation in the industry to soundly capitalized firms. [footnote omitted]. 552 F.2d at 489, 490.

These statements indicate a remarkable judicial insensitivity to the devastating impact of the "double segregation" requirement on the options industry, including Petitioner NASCOD firms. Moreover, this statement lacks support as there was not a scintilla of evidence in the record that any of the NASCOD Petitioner firms are undercapitalized. If the Commission really believes that there is an imminent danger to public investors because NASCOD Petitioner firms are undercapitalized, the solution is not for

it to circuitously drive these firms from the business by imposing "double segregation," but rather to strictly enforce the net capital requirement.

Thus, Regulation 32.6, 17 C.F.R. 32.6 (1976) is devoid of any rational basis or reasonable nexus to the wrongs to be remedied. Neither the Commission nor the Court of Appeals have been able to state with precision what function this bizarre and novel regulation is supposed to serve. This baseless Regulation now threatens to destroy the business of Petitioner NASCOD firms. This Honorable Court should issue a Writ of Certiorari to review the question of the rationality of "double segregation", and remedy the decision of the Court of Appeals.

E.

THERE IS AN IMPORTANT FEDERAL QUESTION AS TO WHETHER REGULATION 32.6, 17 C.F.R. 32.6 (1976) IS VOID FOR VAGUENESS.

The Court should issue a Writ of Certiorari to determine the important Federal question of whether Regulation 32.6 17 C.F.R. 32.6 (1976) is void for vagueness. The Regulation requires that customers' payments remain in segregation until either the option is exercised or "all rights of the option customer under the commodity option have been fulfilled." As drafted, the Regulation provides no standard to determine when "all the rights under the option have been fulfilled." It is therefore impossible for NASCOD Petitioner firms, or a lender who must finance double segregation, to know for how long funds must remain in segregation. The determination of what "all rights under the option" are, and when they have been "fulfilled" may even require judicial interpretation. According to Section 14(a) of the Act, 7

U.S.C., 18(a), any options transaction may be the subject of a reparations proceeding against a futures commission merchant for two (2) years after the cause of action accrues. Furthermore, an options customer has remedies under Federal and state law, with lengthier statutes of limitations. A NASCOD Petitioner firm which must abide by the Regulation therefore cannot determine how long it must continue to segregate funds, and therefore the firm cannot comply in good faith. This Honorable Court should thereupon issue a Writ of Certiorari to determine whether Regulation 32.6, 17 C.F.R. 32.6 (1976) is violative of due process of law because it is thus void for vagueness. See *Brennan v. Occupational Safety and Health Review Commission*, 505 F.2d 869 (10th Cir., 1974).

F.

THE COURT OF APPEALS DEPARTED FROM RULES SET DOWN BY THIS COURT AND FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS BY REVERSING THE PRELIMINARY INJUNCTION UPON AN IMPROPER STANDARD OF REVIEW AND BY GRANTING PREMATURE SUMMARY JUDGMENT.

1. The Court of Appeals did not apply the proper standard of review in reversing the Preliminary Injunction.

The Court of Appeals departed from both the principles set forth by previous decisions of this Court and from the accepted and usual course of judicial proceedings by reversing the District Court's preliminary injunction without a finding

that the District Court had abused its discretion in granting the injunction. The Court of Appeals' Opinion does not apply the "abuse of discretion" standard, but rather merely concludes that "the District Court *erred* in granting plaintiffs' preliminary injunction against the segregation requirements" (emphasis supplied). 552 F.2d at 491. However, this Court has stated in affirming a grant of a preliminary injunction that "the standard of appellate review is simply whether the issuance of the injunction in light of the applicable standards, constituted an abuse of discretion." *Doran v. Salem Inn, Inc.*, 422 U.S. 922, 933 (1975). The application of the lesser standard of review by the Court of Appeals is a departure from the well established principle that the issuance of a preliminary injunction, whatever its form, lies within the discretion of the District Court, and will not be disturbed absent a showing of mistake or abuse of that discretion. *Jacobsen and Company, Inc., v. Armstrong Cork Company*, 548 F.2d 438, 441 (2d Cir., 1977); *Triebwasser and Katz v. American Telephone and Telegraph Company*, 535 F.2d 1356, 1358 (2d Cir., 1976).

2. *The Court of Appeals departed from principles set down by this court and from the accepted and usual course of judicial proceedings by applying an improper standard of factual review.*

In reviewing the granting of a preliminary injunction, a Court of Appeals may not disturb the findings of fact underlying that injunction unless such findings are "clearly erroneous." F.R.Civ.P. 52(a). The District Court's findings of fact in granting the preliminary injunction must be accepted unless they are clearly erroneous under the stringent standard of Rule 52(a). *Unicon Management Corporation v. Koppers Company, Inc.*, 366 F.2d 199 (2d Cir., 1966). This Honorable Court has stated that such findings may not be rejected out of hand, and will stand if supported by evidence. *United*

States v. El Paso Natural Gas Co., 376 U.S. 651, 656-657 (1964). The Opinion of the Court of Appeals is predicated upon factual findings diametrically opposite those of the District Court, without the requisite determination that the District Court's findings were "clearly erroneous." For example, the District Court found:

> "The only reason stated for this admittedly harsh action was the need for speed to protect the public. The Commission does not cite, and we cannot find, any reason or fact which had come to its attention since the Rules were proposed in February without any provision for segregation which would seem to justify this need for haste. (footnote omitted). Such haste seems especially unjustified in view of the admittedly harsh consequences of the rule and the Commission's continuing search for alternatives."

The Court of Appeals is content to conclude that it does not *appear* "that the Commission accepted the requirement with undue haste," 552 F.2d at 482, but does not demonstrate how, if at all, the District Court's contrary finding is "clearly erroneous."

The District Court further decided:

> "Therefore, with respect to the regulation requiring segregation, it is our conclusion of fact that plaintiffs are threatened with irreparable injury in that, being required by the necessities of the business to forward to their principals in London the premium for options they sell to their customers (representing at least 75% of the funds received from customers), they could not long remain in business if required to segregate in the United States an amount equal to 90% of such funds (footnote omitted). It is our conclusion of law that – for the reasons above outlined –

> plaintiffs have a reasonable likelihood of success on the merits of their attack on the segregation requirement. We further conclude, in light of the wide panoply of regulations already and about to be in effect, that the public interest will not be adversely affected by preliminarily enjoining the segregation requirements."

The Court of Appeals never discusses the catastrophic effect that double segregation will have on the options industry except to say that "it threatens to restrict participation in the industry to soundly capitalized firms." 552 F.2d at 490. Similarly, the Court of Appeals reverses the District Court's finding that the public interest will not suffer from preliminarily enjoining the segregation requirement without any finding of clear error or marshalling of contrary facts from the record.

The capstone of the reversal is the determination that the segregation requirement was a "reasonable exercise of its [the Commission's] discretion in an effort to protect the public . . . ," 552 F.2d at 490. The Court of Appeals does not conclude that the District Court's contrary finding that the full regulations available to the Commission is sufficient to protect the public is "clearly erroneous." Rather, the Court of Appeals merely speculates that in the absence of segregation, "a need for capital might prod a dealer into overdependence on the customers' money to finance general operations," 552 F.2d at 489-90, but cites no evidence which gives any support or credence to the speculation. As was discussed heretofore, "double segregation" cannot possibly remedy overdependence by a dealer on customers' funds, because, in the absence of segregation, most of the proceeds are immediately forwarded to the London Exchanges as payment for the option, and are therefore out of control of the dealer.

In yet another instance, the Court of Appeals substituted its own factual findings for those of the District Court by merely reiterating the contentions of the Commission in place of a finding of fact:

> "And the Commission has pointed out that financially stable firms may be able to meet the capital demands of segregation by borrowing and using the interest they obtain on the segregated funds to defray a good part of the cost of borrowing." 552 F.2d at 490.

The District Court, however, with the record of the proceeding before it, noted "the Commission's suggestion that this could be accomplished by bank financing is not persuasive." (footnote 21) In fact, it seems patently obvious that no businessman can borrow millions of dollars, unsecured by any collateral, to finance hundreds of customers' orders for periods ranging from three (3) to eighteen (18) months, particularly when there are no clear guidelines as to when the segregated funds may be released. Therefore, the Court of Appeals had absolutely no basis on which to base this contrary factual finding.

3. The Court of Appeals departed from the accepted and usual course of judicial proceedings by prematurely granting summary judgment.

Rule 56(c) of the Federal Rules of Civil Procedure allows the granting of a Motion for Summary Judgment only when there is no genuine issue of material fact, and the movant is entitled to judgment as a matter of law. The movant has the clear burden of demonstrating both these elements. *Adicks v. S.H. Kress and Company*, 398 U.S. 144 (1970). Viewed in the light of the statutory burden, the Court of Appeal's premature grant of summary judgment in favor of the Commission on the lawfulness of Regulation 32.6, 17 C.F.R.

32.6 (1976) was a complete digression from the accepted course of judicial proceedings. As noted heretofore, the Commission was clearly not entitled to judgment as a matter of law as to the lawfulness of the Regulation. Furthermore, the premature grant of summary judgment entirely aborted NASCOD Petitioners' opportunity and right to conduct discovery on, among other matters, the following material issues of fact;

a. What alternatives to "double segregation" the Commission did or might have considered;

b. Whether the Commission properly considered the deleterious effect of double segregation upon NASCOD Petitioners' business;

c. What specific problems "double segregation" was intended to remedy;

d. What factual grounds underlay the conclusory justifications for "double segregation" set forth by the Commission in its Federal Register Notices of October 8 and November 24, 1976.

e. What efforts, if any, the Commission made to discharge its duties under Section 15 of the Act to consider the policy of the antitrust laws and to endeavor to take the least anti-competitive course of action.

Furthermore, the premature grant of summary judgment deprives NASCOD Petitioners of their right and ability to make a case under Section 10(e)(2)(F) of the Administrative Procedure Act, 5 U.S.C. Section 706 (2)(F). That provision states that a reviewing court shall hold unlawful and set aside agency action, findings and conclusions found to be "unwarranted by the facts to the extent that the facts are

subject to trial de novo by the reviewing courts." Because of the premature summary judgment, NASCOD Petitioners have been entirely deprived of the neans to which they can prove that the action of the Commission in promulgating Regulation 32.6, 17 C.F.R. 32.6 (1976) was unwarranted by the facts. Furthermore, the NASCOD Petitioners have no way of determining whether those parts of the administrative record cited to by the Commission in this proceeding constitute all materials relied upon by the Commission in promulgating Regulation 32.6, 17 C.F.R. 32.6 (1976). For example, NASCOD Petitioners never saw any work papers or memoranda underlying the Reports of the Advisory Committee, or the Federal Register Notices. The question of whether a Court of Appeals can, by the imposition of a premature summary judgment, deprive a plaintiff of its rights to make that a case pursuant to Section 10(e)(2)(F) of the Administrative Procedure Act, 5 U.S.C., Section 706(2)(F)(1970) is an important Federal issue, which this court should consider and adjudicate. There is absolutely no reason here for a precipitous grant of summary judgment, which abruptly terminated the judicial inquiry into the lawfulness of the challenged Regulation. In view of the deleterious effect of that Regulation and its admitted harshness, this Honorable Court should issue a Writ of Certiorari forthwith.

CONCLUSION

For the reasons stated hereinbefore, this Honorable Court should issue a Writ of Certiorari to review the Judgment and Opinion of the Court of Appeals of April 4, 1977 as to the reversal of the preliminary injunction and the premature grant of summary judgment on the issue of the lawfulness of Regulation 32.6, 17 C.F.R. 32.6 (1976).

Respectfully submitted,

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CONCLUSION

For the reasons stated hereinbefore, this Honorable Court should issue a Writ of Certiorari to review the Judgment and Opinion of the Court of Appeals of April 4, 1977 as to the reversal of the preliminary injunction and the premature grant of summary judgment on the issue of the lawfulness of Regulation 32.6, 17 C.F.R. 32.6 (1976).

Respectfully submitted,

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APPENDIX A

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552 FEDERAL REPORTER, 2d SERIES

BRITISH AMERICAN COMMODITY OPTIONS CORP. and Lloyd, Carr & Co., Plaintiffs-Appellants-Cross Appellees,

v.

William T. BAGLEY, Chairman of the Commodity Futures Trading Commission, et al., Defendants-Appellees-Cross Appellants.

NATIONAL ASSOCIATION OF COMMODITY OPTIONS DEALERS, a nonprofit association, et al., Plaintiffs-Appellants-Cross Appellees,

v.

The COMMODITY FUTURES TRADING COMMISSION et al., Defendants-Appellees-Cross Appellants.

Nos. 863, 864, 865, Dockets 77-6010, 77-6011 and 77-6019.

United States Court of Appeals, Second Circuit

Argued Feb. 9, 1977.
Decided April 4, 1977.

Individual commodity options dealers and an association of such dealers brought action to enjoin implementation of rules of the Commodity Futures Trading Commission. The United States District Court for the Southern District of New York, Whitman Knapp, J., granted preliminary injunction against regulation requiring dealers to segregate customer funds but granted summary judgment against the other challenges to the regulations and both

parties appealed. The Court of Appeals, Feinberg, Circuit Judge, held that Commission showed good cause for implementation of its rules less than 30 days after their promulgation; that requirement that 90% of the customer's money be retained in an American account until performance under the option contract is complete was reasonable; and that the registration, disclosure, record keeping, and financial requirement rules of the Commission were reasonable.

Affirmed in part and reversed in part.

* * * * * * * *

Before FEINBERG, GURFEIN and MESKILL, Circuit Judges.

FEINBERG, Circuit Judge:

Nine commodity options dealers and the National Association of Commodity Option Dealers (NASCOD) in this consolidated action challenge new rules that regulate the commodity options industry. The Commodity Futures Trading Commission (Commission) promulgated the rules under authority granted in 1974 by the Commodity Futures Trading Commission Act, Pub. L. 93-463, 88 Stat. 1389, 7 U.S.C. §§1-22 (Supp. V, 1975). Plaintiffs claim that the regulatory scheme violates various requirements of the Administrative Procedure Act, 5 U.S.C. §§551 et seq. (1970), and the United States Constitution. Prior to the effective dates of the new rules, plaintiffs brought suit in the federal courts[1] for declaratory relief, and moved for a

[1] Plaintiffs British American Commodity Options Corp. and Lloyd, Carr & Co. sued in the United States District Court for the Southern District of New York on November 15, 1976, No. 76, Civ. 5124. NASCOD and other plaintiffs filed initially in the United States District Court for the District of Columbia, No. 76, Civ. 2250. Upon learning that

preliminary injunction against implementation of the rules. With the certified record of the informal rule-making proceeding before him, Judge Whitman Knapp of the United States District Court for the Southern District of New York enjoined the regulation that required segregation of customers' funds, but otherwise denied plaintiffs' motion and granted summary judgment for the Commission. We reverse the injunction against the segregation rule, and in other respects affirm the judgment of the district court.

I.

The Commodity Options Industry

The commodities business operates as a market place of contacts. The contracts traded are for the purchase, or sale, of specific amounts of a commodity[2] either that have

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Footnote 1 continued:
the same issues had been presented in New York, the plaintiffs in the D.C. action appeared in New York on December 10, 1976 and argued the motions that led to the instant appeal. The D.C. district court granted a change of venue four days later, and Judge Knapp in New York granted a motion to consolidate the two actions.

[2] The Commodity Futures Trading Commission Act, 7 U.S.C. §2 (Supp. V, 1975), defines "commodity" as

> wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13-1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future deal in. . . .

already been produced, or that will be produced in the future and delivered by a specific date. This latter group of contracts are known as "commodity futures."[3] A "commodity option" is a contractual right to buy, or sell, a commodity or commodity future by some specific date at a specified, fixed price, known as the "striking price."[4] A contract entitled its owner to purchase the commodity is known as a "call," and a contract entitling its owner to sell is called a "put." In the plainest case, an option is created, or "written," by the owner of a commodity or commodity futures contract, who commits himself to sell his goods or contract. But an option can also be written by anyone else willing to take the chance that he will be able to cover his obligation in the futures market, if the option purchaser decides to exercise the option. Such an option is described as "naked."

The plaintiff firms in this case deal in "London options," which are options on futures contracts for certain

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[3] For general descriptions of the market's operation, see R. Tweles, C. Harlow & H. Stone, The Commodity Futures Game (1974); Horn, Commodities, in The Stock Market Handbook 307-15 (F. Zarb & G. Kerekes eds. 1970). See also Johnson, The Perimeters of Regulatory Jurisdiction under the Commodity Futures Trading Commission Act, 25 Drake L. Rev. 61 (1975), which describes the shift in emphasis of commodity regulation from farm interests to investor protection, and Smith, Commodity Futures Trading, 25 Drake L. Rev. 1 (1975).

[4] For a fuller description of commodity futures options and their uses as investment tools, see S. Kroll & I. Shisko, The Commodity Futures Market Guide 258-68 (1973).

commodities that are traded in London, England, on either the London Metals Exchange (LME) or several other exchanges whose transactions are cleared through the International Commodity Clearing House (ICCH). The plaintiff firms sell London options in the United States and, according to plaintiffs British American Commodity Options Corp. and Lloyd, Carr & Co., operate as follows: Plaintiffs actively solicit customers through direct mail and telephone contacts, as well as by newspaper and television advertising. When a customer orders the purchase of a commodity option, the dealer furnishes him with a notice giving the details of the transaction including the nature of the underlying futures contract, the price the writer charges for the option, known as the "premium," the dealer's commission, and the market on which the trade will be executed. The customer may or may not have paid for the option when this notice is sent; only payment of the purchase price to the dealer commits the customer to buying the option. The price quoted in the notice is firm, however, for five days, which means that the dealer assumes the risk of a price increase during that period. Once the dealer receives cash payment, he executes the trade through a "clearing member" of one of the English exchanges. The dealer then immediately forwards the premium amount to the clearing member, who pays the option writer. At the same time, the dealer sends another notice to the customer giving final details of the transaction.[5]

To profit from this purchase, the customer must exercise the option before it expires. Exercising the option means buying the underlying futures contract. Since the customer normally has no interest in actually receiving the

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[5] See Long, Commodity Options – Revisited, 25 Drake L. Rev. 75, 111-128 (1975), for an excellent description of the London options marked and the sale of London options in the United States.

commodity on the delivery date, the clearing member then sells a futures contract short for the customer. The difference between the price at which the option is exercised plus the cost of purchasing the option (premium and commission) and the price at which the futures contract is sold is the customer's profit. If, however, the market price for the futures contract has dropped below the striking price, the customer allows the option to expire, in which case he loses his entire investment.

Market Regulation

Intimations of difficulties in the commodity options market came to the attention of Congress in the early 1970's; existing laws had not worked well in preventing abuses in the options industry.[6] Options were an especially hospitable environment for abuse because a naked option could be created out of nothing, if the writer was willing to run the risk of not covering his obligation by acquiring an offsetting position in the futures market. Thus, entry into the business of options required little capital. In addition, options bear lower price tags than the futures contracts underlying them, so the options market may be peculiarly attractive to individual investors of relatively modest means and with a propensity for taking risks.

Before 1974, regulation of trading in commodity futures and options derived mainly from the Commodity Exchange Act, 7 U.S.C. §§ 1-17b (1970).[7] That Act

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[6] H.R. Rep. No. 93-975, 93d Cong., 2 Sess. 36–53 (1974).

[7] Attempts to invoke the securities laws in his context have met with only mixed success. Compare *Continental Marketing Corp. v. SEC*, 387 F.2d 466 (10th Cir. 1967), with *Glazer v. National Commodity Research and Statistical Service, Inc.*, 547 F.2d 392 (7th Cir., filed Jan. 7, 1977). See generally 1 A. Bromberg, Securities Law; Fraud 82.241-69 (1975); Long, supra note 5.

empowered the Commodity Exchange Authority of the Department of Agriculture to administer certain limited regulations on trading in a number of agricultural commodities,[8] and completely banned options on them. 7 U.S.C. §6c (1970). On October 23, 1974, Congress enacted the Commodity Futures Trading Commission Act, supra, which created the Commission as an independent regulatory agency with plenary rulemaking power. The Act also substantially broadened the field of regulation, to include virtually all "goods and articles," see note 2, supra.[9] The Commission was given

> exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery.

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[8] 7 U.S.C. §2 (1970) provided, in pertinent part:

> The word "commodity" shall mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, onions, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice.

[9] Onions were excepted, in accordance with Pub.L. 85-839, 72 Stat. 1013 (1958), which prohibited all trading in onion futures. Congress took this action after onion producers reported that price variations in the futures market had been adversely affecting the cash price of onions. See S. Rep. No. 1631, 85th Cong., 2d Sess. (1958); H.R.Rep. No. 1036, 85th Cong., 1st Sess. (1957), reprinted in [1958] U.S. Code Cong. & Admins.News, pp. 4210-4215.

7 U.S.C. § 2 (Supp. V, 1975).

The new Act perpetuated the old Act's absolute ban on option trading for the commodities listed in the old Act, 7 U.S.C. §6c(a) (Supp. V, 1975), but permitted other options to be written and to trade in compliance with rules promulgated by the Commission. 7 U.S.C. §6c(b) (Supp. V, 1975). The Act authorized the Commission "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter." 7 U.S.C. § 12a(5) (Supp. V, 1975).

On April 25, 1975, soon after the Commission came into official existence, it published for public comment a proposed antifraud rule, 40 Fed.Reg. 18187 (1975), that broadly proscribed fraudulent and deceptive practices and the making of false statements in connection with commodity options transactions. The anti-fraud rule became effective June 24, 1975. The Commission explained that its swift action was necessary because the Act's grant of exclusive jurisdiction to the Commission had left the public without regulatory protection.

In October 1975, the Commission announced that it was considering rules to regulate or prohibit all options trading. The Commission also announced the appointment of an Advisory Committee on the Definition and Regulation of Market Instruments[10] to study the options situation and

[10]The Committee was composed of seventeen members. It included various industry leaders, exchange officials, economists, attorneys, the Illinois securities commissioner, a farmer-rancher, a consumer representative, and two members of the Commission, one of whom served as the Committee's chairman.

recommend suitable regulations. The public notice solicited suggestions of temporary rules to be adopted, and offered for consideration a number of alternative approaches: prohibition of all commodity options transactions; restricting options trading to established contract markets; allowing trading only of options written as part of a Commission-approved "business plan"; prohibition of "naked" options; or registration by the Commission of dealers who comply with certain Commission fiduciary requirements. 40 Fed.Reg. 49360-62. (1975). The Commission did receive some comments from the public, although apparently none from any plaintiff.

On February 20, 1976, the Commission published its proposed temporary rules to govern commodity options transactions. 41 Fed.Reg. 7774 (1976). The proposal called for all options dealers, among other things, to register with the Commission, to maintain at least $100,000 of working capital, to keep certain records, and to disclose to options customers that certain information about the options dealer could be obtained from the Commission. Notably absent from the proposal was any requirement that the dealer set aside, or "segregate," any portion of the customer's cash payment until the option is sold or exercised. The Commission did, however, indicate that it was "particularly interested" in comments on the wisdom of such a requirement. 41 Fed. Reg. 7776 (1976).

At an oral hearing in March 1976, the Commission received the views of various witnesses, including counsel for British American. The Commission also received written comments, some supporting segregation, and in July 1976, the Advisory Committee transmitted its report, which also supported segregation.

On October 8, 1976, the Commission published proposed interim regulations, intended to become effective on November 22. Written comments from the public were

invited on or before November 8. British American submitted comments and requested oral hearings, which the Commission did not provide. The Commission adopted the regulations, substantially in the form it had proposed, on schedule and gave public notice on November 24, 41 Fed. Reg. 51808 (1976), but delayed effectiveness for 15 days, except that the segregation requirement was delayed 30 days.

The new rules forbid an option dealer to do business after January 17, 1977 unless he is registered as a "futures commission merchant" (FCM) under the Act. 17 C.F.R. §32.3 (1976). To be registered, a dealer has to comply with a new minimum capital requirement, 17 C.F.R. §1.17 (1976), that the dealer maintain adjusted working capital in excess of the greater of $50,000 or a formula figure, one of whose components is five percent of the dealer's aggregate indebtedness. The new disclosure rule, 17 C.F.R. § 32.5 (1976), requires the option customer to be furnished a "summary disclosure statement" prior to the commodity option transaction. The statement must contain, among other things, a brief description of the "total quantity and quality" of the commodity under the option, its duration, the elements comprising its purchase price, the method by which the striking price is established, the amount of the commission to be charged, a statement that the price rise (for a call) or price fall (for a put) must exceed the premium amount plus costs in order for the option customer to make money, and a clear explanation of the possible effects of currency fluctuations on options executed through foreign facilities. Section 32.6 of the new regulations requires an FCM to segregate 90 percent of the payment received from the customer in a United States bank account until expiration or exercise of the option. Also, the rules require an FCM to keep pertinent records for each transaction. 17 C.F.R. §32.7 (1976).

The new rules announced on November 24 differed in several respects from the October 8 version. In addition to postponing the effective dates, as indicated above, the new rules relaxed the earlier proposed requirement that the summary disclosure statement be furnished no less than 24 hours before the transaction. The Commission changed this requirement to allow the statement to be furnished merely "prior" to the transaction, because of public comments that the proposed rule was unrealistic in light of the volatile nature of the commodities markets. In addition, the new rules change the requirement that particularized price information be disclosed before rather than after the transaction. And the amount to be segregated was reduced from 100 percent to 90 percent so that an FCM could immediately get funds for commissions, salaries, and administrative expenses. See 41 Fed. Reg. 51811-13 (1976).

As indicated above, plaintiffs' efforts in the district court to enjoin operation of the new rules were unsuccessful, except for the segregation requirement. Except for that portion of the order, plaintiffs urge us to reverse the judgment of the district court. The Commission cross-appeals and seeks reversal of the injunction against the segregation requirement.

II.

Procedural claims

Plaintiffs claim that the regulations were adopted in violation of the rulemaking notice provision of the Administrative Procedure Act, 5 U.S.C. §553 (1970). The regulatory scheme was published in final form only 15 days before most of it became effective. Plaintiffs argue that this waiting period was impermissibly short under §553(d), which provides that "the required publication or service of a substantive rule shall be made not less than 30 days before

its effective date, except . . . (3) as otherwise provided by the agency for good cause found and published with the rule." The statutory hiatus, plaintiffs assert, allows interested parties a chance to participate meaningfully in the rulemaking process, and enables the agency to educate itself properly. Where, as here, both the system of rules and the agency itself are newly created, this rationale is particularly compelling. Moreover, two plaintiffs charge the Commission with purposeful evasion of the procedural requirement. They claim that the November 24 publication came as a direct response to their November 15 filing of a complaint against the rules in the federal district court, and that since the Commission had indicated that oral hearings on the October 8 proposal would be held sometime in December, the Commission thus actively deterred the firms from participating in the rulemaking process during October and early November. Finally, plaintiffs appear to claim that in any event some sort of oral hearing before the Commission after October 8 was required before the new rules could be issued.

[1] Fairly characterized, however, the Commission's procedures adequately complied with statutory requirements and did no substantial injustice to the plaintiffs. The Commission first published notice of its plan to promulgate regulations in October 1975. The first specific proposal was released on February 20, 1976, and in March oral hearings were held. After consideration of the views there expressed and of the report of the Advisory Committee, the Commission on October 8, 1976 announced its revised proposal, which was finally adopted in substantially the form then proposed. Notwithstanding the language of § 402 of the new Act, 7 U.S.C. §6c(b), which provides that "any . . . order, rule, or regulation may be made only after notice and opportunity for hearing," no oral hearing was required after October 8. *United States v. Florida East Coast Ry. Co.*, 410 U.S. 224, 93 S. Ct. 810, 35 L.Ed.2d 223 (1973). Nor did the Commission announce that there

would be one, as some of the plaintiffs imply. With respect to the time period, plaintiffs appear to argue that the changes between the October 1976 proposal and the final rules announced on November 24 were sufficient to trigger a new 30-day wait. We doubt this, see *Chrysler Corp. v. Department of Transportation*, 515 F.2d 1053, 1061 (6th Cir. 1975); *California Citizens Band Association v. United States*, 375 F.2d 43, 48-49 (9th Cir. 1967), and we note that all the changes appear to have realized the requirements for the plaintiff firms. But in any event, the Commission was not required to delay effectiveness another 30 days if "good cause" for acceleration was "found and published with the rule." The November 24 announcement declared the following:

> In order to assure full and fair consideration of the various proposals that have been made over the many months in which option regulations have been considered, it has not been possible to implement appropriate regulations before now. That consideration having now been completed, however, the Commission finds that the public interest requires that the foregoing rules be adopted without any further delay inasmuch as the public has been without the protection of a comprehensive regulatory program in an area which historically has been fraught with abuses. Moreover, there has been ample notice and public participation in this rule-making proceeding and affected persons have had adequate notice and opportunity to comment on the subject of these rules and the issues involved in their consideration, as well as the terms of the rules themselves substantially as adopted. Furthermore, affected persons have had an adequate opportunity, through prior notices, to take the necessary steps to be in full compliance with the rules by the effective dates thereof.

[2] We agree with Judge Knapp that this statement was adequate to satisfy the requirement of §553, especially since plaintiffs have made no showing of prejudice to them

from the 15-day acceleration of the effective date of the new rules. They had ample time both to participate in the rule-making process and to ready themselves to comply with the rules whose effective date the Commission accelerated. And the segregation requirement, about which plaintiffs complain the most, was delayed for 30 days after November 24.

Segregation

[3] As already indicated, Judge Knapp granted a preliminary injunction against the new segregation requirement. 17 C.F.R. §32.6 (1976). That section requires that 90 percent of the customer's money be retained in an American account until performance under the option contract is complete. But the London exchanges, which allegedly maintain their own systems of customer safeguards, must simultaneously be sent that portion of the customer's money that represents the premium amount. Thus, the American options dealer must himself have the funds to place a major portion of the price of the option he sells in a segregated account. British American estimates that this "double segregation" burden will require it to raise several million dollars in capital, which may be impossible for it. Moreover, plaintiffs argue, such strangulation of the industry is manifestly unnecessary in light of the London exchanges' own system of financial safeguards.

The Commission was not unmindful of these considerations. The October 8, 1976 notice took account of the possibility of heavy capital demands on dealers in London options, and invited suggestions of alternatives. But the Commission stressed then, and repeated in the November 24 publication of the rules as adopted, that its primary purpose was to protect customers' money from the

sort of abuses that have plagued the field.[11] The Commission looked warily at safeguards allegedly implemented abroad, noting that "assets [segregated in the United States] will not be subject to the attachment or other laws or requirements of any other nation." 41 Fed. Reg. 44564 (1976). Evidence in the record raised serious questions about whether the English safeguards would effectively protect the American customer. At the Commission's March 1976 oral hearing, counsel for British American in effect conceded that the London guarantees do not run to options customers in the United States. Moreover, stringent controls on the use of customers' money are particularly sensible in an industry, such as commodity options trading, that attracts some thinly capitalized firms. In the absence of such protection, a need for capital might prod a dealer into over-dependence on customers' money to finance general operations. In that event, if some difficulty should arise in the chain of transactions needed to generate a profit for the customer seeking to exercise his option, he might be left without a readily available source for recoupment of his investment. Thus, the very point plaintiffs raise to challenge the wisdom of requiring domestic segregation – their financial vulnerability – argues strongly for the requirement. And the Commission has pointed out that financially stable firms may be able to meet the capital demands of segregation by borrowing, and using the interest they can obtain on the segregated funds to defray a good part of the cost of borrowing.

[4] Judge Knapp noted that the scheme of regulations as originally proposed in February 1976 had no segregation requirement, and he saw no reason for its hasty addition.

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[11] See, e.g., *SEC v. Continental Commodities Corporation*, 497 F.2d 516 (5th Cir. 1974); *SEC v. Univest, Inc.*, 405 F. Supp. 1057 (N.D.Ill. 1976). See also H.R. Rep. No. 93-975, supra note 6.

He concluded that the preliminary injunction would not adversely affect the public interest, and that "plaintiffs have a reasonable likelihood of success in establishing that defendants acted arbitrarily and capriciously in imposing segregation requirements."[12] He looked to the prospect that the plaintiff firms "could not long remain in business" if required to segregate as one indication that the requirement might be unreasonable.

On the basis of the Commission's justifications and the record before us, we disagree with the district court that the segregation requirement should be enjoined. The Commission's conclusion that in light of past abuses, the public now needs this minimal protection carries great weight. And in any event, the requirement is not unreasonable even if it threatens to restrict participation in the industry to soundly capitalized firms.[13] Nor does it appear that the Commission adopted the requirement with undue haste. The Commission first publicly raised the possibility of segregation in October 1975, although at that time no regulations were put forward. The February 20, 1976 notice again broached the subject. 41 Fed.Reg. 7776. Although the proposed rules published then did not call for segregation, the Commission did request comments on the idea, and in July 1976, the Advisory Committee publicly recommended segregation. Furthermore, the February 1976 proposal had more stringent net capital requirements and apparently compelled the dealer to maintain in the United States assets sufficient to cover not only its customers'

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[12] We agree with Judge Knapp that the proper test to apply was the arbitrary and capricious standard of 5 U.S.C. §706(2)(A). *National Nutritional Foods Association v. Weinberger,* 512 F.2d 688, 700-01 (2d Cir.), cert. denied, 423 U.S. 827 (1975).

[13] Indeed, the rulemaking power vested in the Commission by Congress allows the possibility that the Commission might ban options transactions altogether. 7 U.S.C.§ 6c(b) (Supp. V, 1975).

investments but also even the unrealized gains on the customer's options. 41 Fed. Reg. 7783-84 (1976)[14]. When in October 1976 the Commission's new proposal relaxed the net capital requirements, the segregation rule that replaced it was by no means a complete surprise. The Commission had, with the aid of public participation, been considering it for almost a full year. Nor did the Commission's examination of the segregation rule cease with publication of the October 8 proposal. That version required 100 percent segregation, but the Commission reduced that figure to 90 percent in the final rule.

We conclude, therefore, that the Commission's decision to impose a segregation requirement was a reasonable exercise of its discretion in an effort to protect the public, and that the Commission's analysis of the problem and alternative solutions was adequately deliberate. We hold that the district judge erred in granting plaintiffs a preliminary injunction against the segregation requirement.

Registration

Under 17 C.F.R. §32.3 (1976), all commodity options dealers must register with the Commission by January 17,

[14] The February proposal required the dealer to maintain $100,000 in net working capita. Moreover, the proposal required computation of net working capital as of the close of each business day, in accordance with a prescribed method designed to take into account the exposure that a commodity option dealer might experience "should the market move against the dealer and in favor of a purchasers." See 41 Fed. Reg. 7778 (1976). This approach was tailored to a market in which a dealer was allowed to both write and sell options. By October, the Commission had decided against allowing dealers to write options. 41 Fed. Reg. 44560 (1976).

1977. Plaintiffs attack the requirement on several grounds: (1) the Commission's position that it could not assure applicants that their filings would be processed by the deadline unless filed by December 27 was unreasonable because Judge Knapp only upheld the regulations on December 21; (2) the regulation's structure – requiring registration by January 17, 1977 rather than filing – vests the Commission with unbridled discretion to exclude any applicant from the options business simply by not acting on the application for registration; (3) section 32.3 conflicts diametrically with 17 C.F.R. §1.19 (1976): the former requires options dealers to register as FCM's, and the latter section forbids FCM's to "make, underwrite, issue, or otherwise assume any financial responsibility for the fulfillment of, any [option transaction]."

[5] Plaintiffs' first two arguments are in essence that the Commission acted high-handedly in proclaiming the January 17 deadline. Especially since the agency confronted a previously unregulated field, plaintiffs stress, it should have made conscientious efforts to avoid unnecessarily disrupting the industry. We agree that the laudable intent to protect the public cannot give regulators unbridled freedom to do as they wish. Viewing the Commission's conduct here as a whole, however, we do not believe that there was substantial injustice or grautious disruption. Plaintiffs did have reasonable advance notice that registration would be required and could not rely on the possible success of their lawsuit as an excuse for not being prepared to file. Moreover, the Commission has not dragged its feet on the applications filed. After oral argument, the Commission advised us by letter that it had not yet acted on the filings of only two of the plaintiff firms, both of which had filed during January. Three other plaintiffs remain unregistered, but they are the subjects of administrative proceedings brought by the Commission to determine whether registration should be refused. Under the circumstances, the attack on the registration requirement must fail.

[6] Similarly, there is no merit to the argument that §32.3 may conflict with § 1.19 and thereby, in effect, preclude plaintiffs from engaging in the commodity option business. The American firms dealing in London options operate solely as agents, a role the Commission has not deemed to constitute an assumption of "financial responsibility" barred by §1.19. British American and Lloyd, Carr urge that the Commission "can always take the position that sinee the retail London commodity options dealers are responsible for transmitting customer funds to and from London they 'otherwise assume financial responsibility,'"[15] thereby violating § 1.19. However, as long as the Commission construes its own regulations consistently, plaintiffs' claim is devoid of merit. If the Commission acts inconsistently – and we do not assume or suggest that it will – plaintiffs have shown that they know how to go to court to protect their rights.

Disclosure

Implementation of the disclosure requirements in the new regulations correlates with a decline in options sales for plaintiffs. For example, British American tells us that its gross options premiums per month dropped from $2,238,748 in November 1976 to less than $1 million in December. Net income from options simultaneously fell off sharply. British American attributes this decline to the Commission's "severe" and "punitive" requirements which seriously disadvantage options dealers in competition with dealers of futures contracts or stock options. They further argue that it is unfair not to make the requirements also applicable to traders only of futures since the customer takes a greater risk in a futures transaction: A futures customer may be subject to margin calls, whereas the commodity options customer, who pays the full premium in cash, cannot be.

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[15] Brief of appellants British American and Lloyd, Carr at 40.

[7,8] We do not doubt that full disclosure of commissions and fees and a clear statement of what must happen before the customer makes money from his option cool the public's ardor for options. But the Commission concluded that such disclosure is an effective way to help the public make informed investment decisions. We cannot say that this judgment was arbitrary or irrational. Indeed, it seems sensible; the very fact that the disclosures have so drastically affected plaintiffs' business supports the Commission's position. As for the comparative leniency of disclosure requirements for futures and stock options,[16] the Commission was entitled to rely on the added supervision of those markets,[17] and the extensive disclosures required from the issuers of the securities that underlie stock options.

Minimum Financial Requirements

[9] Plaintiffs also attack the minimum capital requirement for FCM's, 17 C.F.R. § 1.17 (1976), as arbitrary, capricious, and unreasonable. Plaintiffs complain that the $50,000 minimum is arbitrarily pegged at five times the minimum requirement for commodity futures dealers, even though futures trading involves much greater sums of money than options trading. Furthermore, plaintiffs argue, the definition of "aggregate indebtedness" in § 1.17 pits the dealer's interest against that of his clients by requiring the dealer "to take a 5% 'haircut' on customers' equity."[18]

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[16] Stock options trading is regulated by the Securities and Exchange Commission, not by the Commodity Futures Trading Commission.

[17] For a summary of regulation of futures trading and commodity futures exchange activities under the new Act, see Smith, supra note 3, at 33-44.

[18] Brief of appellants British American and Lloyd, Carr at 44.

By this plaintiffs mean that as the value of a customer's option goes up (if that happens), the dealer's indebtedness to the customer is deemed to rise simultaneously so the dealer must augment his working capital by 5 percent of the increase.

With respect to the $50,000 minimum, the Commission explained in its November 24 notice: "Based on its experience,. . ., the Commission believes that the distinction in working capital requirements between futures commission merchants who are engaged in options activity as opposed to those who are not, is necessary to provide a cushion against losses which are more likely to arise in the commodity options area." 41 Fed.Reg. 51813 (1976). In support of its position, the Commission points out that a FCM dealing only in futures contracts must reassess its position on a daily basis in light of unrealized gains and losses on its customers' contracts. Also, industry self-regulatory organizations, which monitor futures dealers, can detect early signs of a firm's financial instability. We cannot say that the Commission's judgment was arbitrary.

Regarding the inclusion of customers' equity as part of aggregate indebtedness, there has been some confusion among the parties as to precisely what the requirement is. In affidavits filed with the district court on December 3, 1976, and with this court on January 13, 1977, counsel for British American indicated that the difficulty had arisen from conflicting agency interpretations of the requirement. On December 1, 1976, the Acting Branch Chief of the Commission's Eastern Regional Office wrote to Crown Colony Options, Ltd., that the "haircut" was required by §1.17. Yet on December 3 the Commission's auditing staff began applying a policy of not requiring the "haircuts" when the FCM acts solely as an agent. And in this court the Commission has again conceded that unrealized gains on options contracts will not be treated as amounts payable to customers for purposes of the net capital computation. With the Commission's position thus clarified, plaintiffs' claim evaporates.

Other Claims

[10] NASCOD argues that the recordkeeping requirements in §32.7 may be unnecessary, especially the requirement that the FCM maintain a list of all prospective commodity option customers to whom solicitations are directed. We accept the Commission's justification that

> This provision imposes no greater burden than placing a check mark next to the name and address of the customer on the solicitation list utilized. Moreover, the Commission believes that this information, as well as its books and record-keeping requirements generally, will assist in the Commission's monitoring of the activities of persons offering commodity option transactions for compliance with the interim rules.

41 Fed. Reg. 51813 (1976).

Plaintiffs claim throughout that the district court erred in granting summary judgment because issues of material fact remained unresolved. In sum, we are told that "genuine material questions of fact were raised concerning whether the Commission acted arbitrarily and capriciously."[19] But it is quite clear, as we have already held, that the Commission's actions were not arbitrary or capricious. If plaintiffs' contention is that the district court was required to hear new evidence on the justification for the regulations issued by the Commission, we do not agree. See *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 414-415 (1971). Plaintiffs have also advanced other arguments, which we have considered and found to be without merit. Accordingly, the judgment of the district court is affirmed except for the grant of injunctive relief against the segregation requirement, and as to that portion of the order we reverse.

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[19] Brief of Appellants NASCOD, et al, at 10.

APPENDIX B

UNITED STATES COURT OF APPEALS
Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit held at the United States Court House, in the City of New York, on the sixth day of June, one thousand nine hundred and seventy-seven.

Present:

HON. WILLFRED FEINBERG,
HON. MURRAY I. GURFEIN,
HON. THOMAS J. MESKILL
Circuit Judges.

DOCKET NO. 77–6010
Filed June 6, 1977

A petition for a rehearing having been filed herein by counsel for the NATIONAL ASSN. OF COMMODITY OPTION DEALERS.

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

/s/ A. DANIEL FUSARO,
Clerk

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

76 Civ. 5124

MEMORANDUM AND ORDER

76 Civ. 2250

KANPP, D.J.

Plaintiffs British American Commodity Options Corporation and Lloyd, Carr & Company, and the National Association of Commodity Option Dealers, et al.,[1] seek both injunctive and declaratory relief to restrain the defendants, Commissioners of the Commodity Futures Trading Commission (hereinafter "the Commission"), from enforcing regulations concerning commodity option transactions published in the Federal Register on November 24, 1976 of which part went into effect on December 9, part is to go into effect on December 27, and the balance is to go into effect on January 17, 1977. 41 Fed. Reg. 51808 Plaintiffs have moved for a preliminary injunction, and defendants have cross-moved for summary judgment. For the reasons which follow, we in part grant and in part deny defendants' motion for summary judgment; and we grant plaintiffs' motion for a preliminary injunction with respect to the portion of the regulations which is to take effect on December 27, 1976, and otherwise deny such motion.

The jurisdiction of this court, which the defendants have not contested, is premised on 5 U.S.C. §701 et seq., 7 U.S.C. § 3, 28 U.S.C. §1331, 28 U.S.C. §1337, 28 U.S.C. §2201 and §2202.

The plaintiffs are dealers in "options" in certain commodities trading on certain exchanges in London,England. That is say they sell their U.S. customers options to buy future contracts traded on those exchanges. They mount a wide variety of attacks upon the rules and regulations of the Commission. We find only one of these to have merit, and the major part of this opinion will be devoted to explaining our difficulty with that regulation. Therefore we shall briefly deal with plaintiffs' other criticisms. The regulation as to which we find the complaint to have merit is the one, effective December 27, 1976, which requires plaintiffs to segregate 90% of the price their customers pay them for the options. In view of the circumstance that the nature of plaintiffs' business – in which they act as agents for London principals – requires them to immediately transfer to London about 75% of such purchase price, we find this segregation requirement to be a hardship which – as we shall develop – the Commission does not seem to have adequately justified.

FACTS

On October 23, 1974 the Congress enacted the Commodities Futures Trading Commission Act of 1974 (hereinafter "the 1974 Act"). 88 Stat. 1389. This Act in effect constituted a series of amendment to the Commodity Exchange Act, which had initially been enacted in 1936. The 1974 Act created the Commission as an independent federal regulatory agency, and referred to it certain regulatory functions previously within the jurisdiction of the Department of Agriculture. The Act further vested the Commission with additional authority.

As enacted in 1936, the Commodity Exchange Act set up methods of regulating trade in contracts of sale for future delivery of certain commodities ("futures"). That Act

also prohibited (illegible) in "options" with respect to the commodities regulated.[2] The 1936 Act covered only specifically designated commodities.[3] The 1974 Act expanded the definition of commodities subject to regulation to (illegible) virtually all previously unregulated commodities, by bringing within its scope all "goods and articles . . . and all services rights and interests in which contracts for future delivery are presently or in the future dealt in . . . "[4]

With respect to the commodities previously regulated, the 1974 Act continued the absolute prohibition on trading in options.[5] However, with respect to trading in options in the newly covered commodities, the 1974 Act authorized the Commission either to extend the absolute prohibition to such trading or to subject it to regulation.[6]

The plaintiffs in this action deal in "options" in previously unregulated commodities[7] and challenge the regulations the Commission has imposed upon them pursuant to the 1974 Act.

So far as here relevant, the pertinent statute provides:

> "No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this Act, but not specifically set forth in section 2 (a) of this Act, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an 'option', 'privilege' 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty', contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or

> allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: Provided, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: And provided further, That the Commission may set different terms and conditions for different markets."[8]

Legislative History of the 1974 Act

The Congressional decision to expand the commodities subject to regulation arose out of the financial failure of at least one company, Goldstein, Samuelson, Inc. which sold options in the unregulated commodities for which no underlying futures contract had been purchased so that customers who tried to exercise their options were defrauded. Congressional hearings focused on this scandal.[9]

This led the House of Representatives to first consider a bill which expanded the commodities subject to regulation and extended the prohibition on trading in options to all these commodities. H.R. 11955.[10] However, following hearings at which several witnesses testified that options trading might be economically useful and that regulations could be devised to protect option purchases,[11] the House introduced a new bill, H.R. 13113, which authorized the Commission to decide whether to ban or regulate option trading in the newly regulated commodities. This section of H.R. 13113 is substantially the same as that finally enacted into law and reads as follows:

"No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this Act, but not specifically set forth in section 2 (a) (1) of this Act, prior to the enactment of the 'Commodity Futures Trading Commission Act of 1974', which is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty', contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission may prescribe: Provided, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: And provided further, That the Commission may set different terms and conditions for different markets."

The House report on this portion of the bill states:

"Options Trading (Section 402)
The discretionary authority granted the CFTC to regulate or ban trading in options in commodities . . . is not to be exercised by the Commission to approve any transaction of the character of, or commonly known as an 'option', . . . if the option or transaction named does not guarantee the purchase of the futures contract in fulfillment of the option, should the purchaser seek to exercise the option. The Committee intends the Commission act as expeditiously as possible to prohibit such transaction."[12]

The Senate amended this portion of the House bill to require the Commission to prescribe regulations governing options within one year after the effective date of the bill and to clarify the jurisdiction of the Commission relative to that of other regulatory agencies. The Senate otherwise retained the language of the House bill. The Senate Committee report on which the Senate had acted stated:

> "The Committee intends that options not be traded except on organized exchanges and in conformity with the rules and regulations of the Commission."[13]

The Conference Committee report does not contain any reference to any limitation on the scope of the Commission's (illegible). The Conference substitute embodied the House provision as amended by the Senate with a further amendment which according to the Conference report provided that:

> "The period for issuing regulations governing such options trading may be extended if the Commission determines, and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture, that it will be unable to promulgate such regulations within" the one-year period.[14]

Both Houses adopted the Conference substitute which became §4 c (b) of the Commodities Exchange Act. Under this statutory provision, option dealers in commodities not regulated prior to 1974 could continue to do business in their accustomed manner until the Commission – by regulations promulgated after notice and opportunity for hearing – either required them to do otherwise or prohibited trading in options.

History of this Rulemaking

On April 25, 1975 the Commission published its first set of proposed rules pursuant to §4c(b). 40 Fed. Reg. 18187. Termed "antifraud rules", these were designed to prevent deceptive practices in connection with the sale of commodity options. The Commission adopted these in amended form on June 24, 1975 to take effect immediately. 40 Fed. Reg. 26504.[15]

On October 22, 1975 the Commission published notice that it was "considering the adoption of further rules to regulate – or perhaps forbid – transactions in commodity options". 40 Fed. Reg. 49360. The regulations ultimately adopted by the Commission pursuant to this rulemaking are those challenged in the instant action. The basis and purpose for considering rules additional to the antifraud rules was stated to be:

> "Commodity-option offerings appear to have proliferated, and many of these offerings appear questionable since in most cases investors are not given adequate assurance that the issuers of the options will be able to perform their obligation under the option contracts when and if required to do so." 40 Fed. Reg. 49360

The borad alternatives under consideration included: prohibiting all commodity option transactions, restricting these to contract markets, allowing only those sold in accordance with a "business plan" approved by the Commission and/or allowing only those sold by persons registered with the Commission. The Commission assigned to an Advisory Committee the responsibility of making recommendations to the Commission. 40 Fed. Reg. 49360. This Advisory Committee was composed of fourteen

persons. Two were Commissioners of the five-member Commodity Futures Trading Commission.[16] The remaining twelve were mainly from law firms and private industry.[17]

The Commission invited the public to submit comments to both it and the Advisory Committee on these broad alternatives and specific enumerated issues. The concept of segregation was not specifically mentioned at this time. The Commission further stated that pending receipt of the Advisory Committee's recommendations and digestion of public comments it might adopt temporary rules without further public notice should it find these urgently necessary "to protect the public".

After considering the comments submitted in response to its October 22, 1975 notice, the Commission published proposed for comment on February 20, 1976. 41 Fed. Reg. 7774.[18] It proposed that all commodity option dealers be required: to register with the Commission as commodity option dealers, to file a disclosure statement with the Commission and inform each customer such was publicly (illegible) at the Commission, and to meet minimum financial standards (that assets exceed liabilities and that "net working capital" exceed $100,000 excluding the premiums received from customers).[19] Commodity option dealers who failed to meet these requirements would be prohibited from trading in options.

However, the Commission stated it would entertain requests for exemptions from the net working capital requirement from those commodity option dealers "who act solely on an agency basis for other dealers who issue or assume full financial responsibility for the commodity option transaction" since it recognized that the requirement "may be inappropriate" for these agent dealers.[20]

The Commission further stated it had decided not to require commodity option dealers to segregate funds received from customers until the option was exercised or expired "because of inherent difficulties of ascertaining which dealer should segregate (i.e., the problem of double segregation)".[21] Nontheless, the Commission stated it was "particularly interested in receiving comments as to whether such a requirement could and should be imposed".[22]

In addition the Commission stated that after it received the Advisory Committee report and comments to these proposed rules:

> "the Commission will determine whether it will require additional time to study the recommendations and comments in order to evaluate the extent to which they should be included as part of a permanent regulatory program. If the Commission believes that such additional time is required, the proposed rules may be adopted as interim and temporary rules only." 41 Fed. Reg. 8884.

After publication of these proposed rules, the Commission received many comments, and on March 8, 1976 it held a public hearing. On July 6, 1976 it received the report from its Advisory Committee.

The Chairman of the Advisory Committee, who also was the Vice-Chairman of the Commission, prefaced this report with the question "Commodity Options in the U.S.: What test;" He stated "The statute, itself, is silent." However, he noted that the Act includes standards guiding Commission regulation of *futures* and that:

> "It has been suggested that the Commission apply the same test for options that it applies for

futures contracts, *i.e.,* that 'they not be contrary to the public interest . . . I suggest the Commission require that proponents of option trading should be prepared to meet requirements and procedures similar to those required by the Commission for futures trading on contract markets which are designated by the Commission."[23]

The Advisory Committee followed its Chairman's suggestions and recommended to the Commission that options dealers should be subject to the same basic requirements that are imposed on futures merchants. One of the requirements it therefore recommended was that options dealers segregate funds received from customers.[24]

The Advisory Committee did not indicate whether or not it had taken into account the circumstance that options dealers – who act as agents and have to forward to their principles funds received from customers – would find this segregation requirement more burdensome than futures dealers who act as principals for their own account. They did, however, state the recommendations were tentative and preliminary since the area of commodity option trading was complex and the data on which the recommendations were based was inadequate.[25]

On October 8, 1976 the Commission published a modified version of its February proposals which it termed "proposed interim regulations" to take effect November 22, 1976. 41 Fed. Reg. 44560. It also invited comment as to whether these should be modified prior to their adoption.

The reason given for adopting these as "interim regulations" was that the Commission planned in 90 days to put into effect a second stage of regulations. The Commission described this proposed second stage as:

"comprehensive regulations for a limited, rigidly–controlled three-year (or shorter) test program that ultimately will require commodity options to be purchased and sold on or through the facilities of Commission-designated boards of trade . . ."

The Commission further stated:

"The test program will be designed to determine the nature and extent of the impact of commodity option trading on the underlying futures and cash markets, the economic utility of commodity option trading and the capability of the exchanges to conduct adequate market surveillance and to assure orderly markets . . . the test program will enable the Commission to obtain sufficient data on which to have a permanent regulatory program concerning commodity options or, if necessary, to determine to prohibit trading in commodity options in the United States." 41 Fed. Reg. at 44560.

Among the interim regulations proposed to take effect in November, 1976 was §32.6 which provided for segregation.[26] In proposing this regulation the Commission recognized that it might cause hardship, especially to those who – like plaintiffs – act as agents for members of London exchanges. Thus the Commission (illegible)

"The Commission is aware that proposed §32.6 may, in certain cases, require 'double segregation.' For example, in the case of the sale of London options, a person receiving the funds from an option customer in the United States as payment for the option may not remit those funds to London in order to obtain or maintain the option position with a London broker. The Commission

> believes that the proposed segregation requirements are an essential customer protection to be afforded commodity option customers in the United States. The Commission recognizes, however, that its proposed segregation requirements may impose a financial hardship on some affected persons." 41 Fed. Reg. 44562.[27]

The Commission accordingly requested comments and suggestions for viable alternatives.

After receiving several comments, the Commission published revised rules on November 24, 1976, which are those now under challenge. 41 Fed. Reg. 51808. Insofar as concerns segregation, the Commission revised the amount to be segregated, reducing it from 100% of the funds received from customers to 90% of those funds.[28] Despite this reduction the Commission reiterated its recognition that adoption of this segregation requirement might impose hardship "particularly with respect to the sale of London options", but simply stated that no acceptable alternative susceptible of immediate implementation had been suggested. Thus the Commission observed:

> "Several commentators have indicated that letters of credit, bonding requirements, and other forms of financial guarantees could be used as alternatives to segregation. While the Commission believes that these suggestions are on the whole constructive, and while the Commission would urge continued efforts by commentators to suggest suitable alternatives to the segregation requirement, specific proposed alternatives have not yet been submitted which would be capable of being effectuated to coincide with the adoption of the interim rules. Accordingly, the Commission has determined to include segregation requirements in the interim rules as adopted . . . " 41 Fed. Reg. 51812

The Commission did indicate that it would consider applications for exemption from the segregation requirement, but made quite clear that it would subject such applications to rigorous scrutiny, and that exemptions would be granted only if "the Commission finds, in its discretion, that it would not be contrary to the public interest to grant such exemption." 41 Fed. Reg. at 51812.

DISCUSSION

With respect to the regulation requiring segregation, the essential facts are that as first proposed in February, 1976, the rules contained no such requirement. The Commission then specifically noted that such a requirement might well be inappropriate for some option dealers. In July, the Advisory Committee specifically noted that the underlying statute provided no standards to guide its determination. Indicating that it would look for guidance to the standards and methods used in regulating dealers in futures contracts it recommended that option dealers be required to segregate. There is nothing in the Advisory Committee report to suggest that it had considered whether such a requirement – which had originally been devised to apply to dealers in futures contracts who normally act as principals – could be appropriately applied to option dealers who, like plaintiffs, act only as agents.

Acting on the Advisory Committee's report and other comments, the Commission in October for the first time proposed (illegible) requiring segregation, specifically calling attention to the (illegible) involved and calling for the suggestion of alternatives. Having rejected all alternatives which were suggested on the ground they were not susceptible of immediate implementation, the Commission in November announced adoption of its interim segregation rule – to take effect December 27, 1976.

The only reason stated for this admittedly harsh action was the need for speed to protect the public. The Commission does not cite, and we cannot find, any reason or fact which had come to its attention since the rules were proposed in February without any provision for segregation which would seem to justify this need for haste.[29] Such haste seems especially unjustified in view of the admittedly harsh consequences of the rule and the Commission's continuing search for alternatives. In the cirumstances, we must conclude that plaintiffs have a reasonable likelihood of success in establishing that defendants acted arbitrarily and capriciously in imposing segregation requirements – at least as applicable to option dealers, who, like plaintiffs, act only as agents. See e.g., *National Nutritional Foods Association v. Weinberger* (2d Cir. 1975) 512 F.2d 688, 701, *cert. den.* 423 U.S. 827.

Although it has not been claimed that the authority (illegible) the Commission pursuant to §4c(b) constited an invalid delegation of authority because of the Congress' failure to provide any standards to guide the Commission, we do note that the Commission's Vice-Chairman has specfically observed that the statute is silent on matter of standards. See p. 10, *supra.* Whether or not such failure to provide standards could be said to invalidate this portion of the legislation (compare *Panama Refining Company v.Ryan* (1936) 293 U.S. 388 and Wright, *Beyond Discretionary Justice,* 81 Yale L.J. 575 (1972) with Davis, *A New Approach to Delegation,* 36 U. Chi. L.R. 713 (1969), such failure should at least be deemed to impose on the Commission the obligation of taking particular pains to ensure that its rulemaking will not be arbitrary and capricious. See Davis *op. cit., supra.*

Therefore, with respect to the regulation requiring segregation, it is our conclusion of fact that plaintiffs are

threatened with irreparable injury in that, being required by the necessities of their business to forward to their principals in London the premiums for options they sell to their customers (representing at least 75% of the funds received from customers), they could not long remain in business if required to segregate in the United States an amount equal to 90% of such funds.[29a] It is our conclusion of law that – for the reasons above outlined – plaintiffs have a reasonable likelihood of success on the merits of their attack on the segregation requirement. We further conclude, in light of the wide panoply of regulations already and about to be in effect, that the public interest will not be adversely affected by preliminarily enjoining these segregation requirements.

In addition to the above discussed claim with respect to segregation, plaintiffs British American and Lloyd, Carr put forth a wide variety of contentions as follows:

1. defendants violated the Administrative Procedure Act (A.P.A.) 5 U.S.C. §553 by failing to give an opportunity for meaningful public comment on the rules published November 24, 1976 and by publishing a portion of these rules to be effective in less than 30 days without good cause.

2. defendants' actions are unsupported by substantial evidence in violation of 5 U.S.C. §706(E).

3. the minimum financial and the disclosure requirements adopted are arbitrary and capricious in violation of 5 U.S.C. §706(2)(A).

4. the defendants acted in excess of their statutory jurisdiction under the Commodities Exchange Act §15 7 U.S.C. §19 in that the regulations promulgated are anti-competitive.

5. the defendants acted "without due process as guaranteed by the Fifth and the Fourteenth Amendments to the Constitution since the defendants are not authorized to put the plaintiffs out of business through the imposition of rules".[30]

We find none of these to have merit.

With respect to the claim that defendants violated the Administrative Procedure Act, 5 U.S.C. §553 by promulgating rules November 24, 1976 which allegedly were substantially different from earlier rules without having given the public the opportunity for meaningful comment thereon, we find the Commission provided adequate notice of each of the provisions now contained in its rules and adequate opportunity to comment thereon. To meet this section of the A.P.A., which requires the agency to give notice of proposed rules and to give interested persons an opportunity to participate in the rulemaking, it is sufficient that the proposed rules to which comments are addressed give reasonable notice of the subjects and (illegible). The Administrative Procedure Act does not require that the rules adopted be identical to those proposed. *California Citizens Band Association v. United States* (9th Cir. 1967) 375 F.2d 43.

With respect to the claimed violation of §553(d) – in that a portion of the Commission's rules published November 24, 1975 were to take effect less than 30 days thereafter, we find the Commission adequately stated and published good cause for its action.[31] Thus, it met the terms of the exception to the requirement of 30-day publication found in subsection (3) of §553(d)[32]

Plaintiffs' claim that defendants' actions are unsupported by substantial evidence cannot be considered. 5

U.S.C. §706(E) makes it clear this standard of review is applicable only to rulemakings pursuant to 5 U.S.C. §556 and §557. The rulemaking here involved was not required to be conducted pursuant to those sections of the Administrative Procedure Act since the Commodities Exchange Act §4c(b) does not require these hearings to be "on the record." Section 4c(b) of the Act requires only that regulations concerning options be made "after notice and opportunity for hearing."

One of the attacks upon the minimum financial requirements as arbitrary and capricious rests on the theory that the segregation requirements will unduly deplete plaintiffs' assets and thus prevent them from meeting the minimum financial requirements. That argument has been disposed of by our ruling with respect to segregation. At oral argument we were persuaded that the other arguments against the minimum financial requirements were grounded upon a misunderstanding of the Commission's regulations.

The claim that the disclosure requirements are arbitrary and capricious also rests on plaintiffs' erroneous reading of the regulations. We accept the Commission's representation at oral argument that plaintiffs are not required to specify the exact results of currency fluctuations and other items not susceptible of knowledge at the time of a sale, but a required only to list and explain such uncertainties. In connection with price items, the requirement is to explain the elements and the method of calculation. The disclosure requirements otherwise appear to us to not be arbitrary or discriminatory.

The claim that the Commission failed to adopt the least anti-competitive means and that this violates the Commodities Exchange Act §15, 7 U.S.C. §19 (Supp. V., 1975) raises no question for us to review. The section cited

does not require the Commission to adopt the least anti-competitive means but only requires it to

> "*take into consideration* the public interest to be protected by the antitrust laws *and endeavor to take* the least anticompetitive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation . . . " (emphasis supplied).

Plaintiffs have shown us no reason to challenge the Commission's statement that it did consider the anti-competitive impact of various alternatives. 41 Fed.Reg. 51809.

In view of our decision with respect to the segregation requirements, the claim that defendants acted without due process "since the defendants are not authorized to put the plaintiffs out of business through the imposition of rules" can be dismissed since plaintiffs are not in danger of being put out of business.[33]

In addition to the claims made by the original plaintiff, the National Association of Commodity Option Dealers has claimed that the requirement that *option dealers* register as "futures commission merchants" is in excess of statutory authority because the Commodities Exchange Act specifically defines futures commission merchants as "individuals . . . engaged in . . . [the] sale of any commodity for future delivery on or subject to the rules of a contract market . . . . "[34] The Commission has itself answered this in the Federal Register notice of November 24, 1976:

> "One commentator suggested that the Commission's determination to make it unlawful for persons to accept money and other funds from

> option customers unless registered as futures commission merchants was, in effect, an amendment of the Act's definition of a futures commission merchant. The Commission disagrees. Persons who come within the definition of futures commission merchant in section 2(a)(1) of the Act are required to register as such thereunder. The Commission's adoption of the interim rules in no way alters that obligation and in no way alters the definition of futures commission merchant contained in the Act. Rather, as the Commission stated at the time of its October 8, 1976 proposal, the Commission has determined, pursuant to its plenary power to regulate commodity option transactions, to entrust options activities only to persons who meet the basic financial and other requirements of futures commission merchants and associated persons of specified futures commission merchants under the provisions of the Act and the regulations promulgated thereunder."

We think this adequately disposes of the argument.

CONCLUSION

On the basis of the foregoing we deny plaintiffs' motion for a preliminary injunction except as it applies to that portion of its rules requiring segregation (§32.6). With respect to that requirement, the defendants are preliminarily enjoined from enforcing it against any plaintiff who is in the business of selling options as an agent.

The defendants' motion for summary judgment is denied with respect to the said requirement of segregation, and is otherwise granted.

Settle order on notice.

Dated: New York, New York
December 21, 1976.

/s/ WHITMAN KNAPP, U.S.D.J

FOOTNOTES

[1] The National Association of Commodity Option Dealers, et al. filed its complaint in the District Court for the District of Columbia, and the case was assigned to Judge Robinson, 76 Civ. 2250. Upon hearing that the issues had already been presented to this court and might be decided here first, they consented to a change of venue. They then appeared and argued at the hearing on the instant motions held in this court on December 10, 1976. Judge Robinson granted a change of venue to this court on December 14, 1976. Plaintiffs then moved to consolidate their complaint with that of plaintiffs British American and Lloyd, Carr. We hereby grant that motion.

[2] A commodity option gives the purchaser the right, during a specified period of time, to buy ("call") and/or sell ("put") at a set price a specific futures contract or, in the case of an option on an actual commodity, a specific quantity of that commodity. In the case of so-called "London options" of the type offered by plaintiffs here, the option relates to futures contracts on commodities traded on the London commodity markets.

[3] Commodities Exchange Act §2(a), 7 U.S.C. §2. The number of commodities regulated increased from time to time after 1936. See the Advisory Committee Report to the Commission, July 6, 1976 ("the Advisory Committee Report"), p. 96, n. 37.

[4] Commodity Futures Trading Commission Act of 1974, §201, Section 2(a) of the Commodities Exchange Act as amended, 7 U.S.C. §2 (Supp. V. 1975).

[5] Commodity Futures Trading Commission Act of 1974 §402, Commodities Exchange Act as amended, §4c(a), 7 U.S.C. §6c(a) (Supp. V, 1975).

[6] Commodity Futures Trading Commission Act of 1974, §402, Commodities Exchange Act as amended, §4c(b), 7 U.S.C. §6c(b) (Supp. V, 1975). The 1974 Act also gave the Commission exclusive jurisdiction to regulate these. Commodities Exchange Act §2(a)(1), 7 U.S.C. §2 (Supp. V, 1975).

[7] Plaintiffs British American and Lloyd, Carr act as agents for others who write options on two London exchanges.

[8] The 1974 Act §402, the Commodities Exchange Act as amended §4c(b), & U.S.C. §6c(b) (Supp. V, 1975).

[9] Plaintiffs state the Congress focused on only one large failure which defrauded customers, whereas defendants maintain it focused on several. Defendants brief on summary judgment, p. 7.

Congressional hearings documented that Goldstein Samuelson, Inc. had started business with a thin capital base, and had conducted business by collecting premiums from unsophisticated investors and using these to pay off the customers who exercised their options. The company had obtained few futures contracts to "cover" or "hedge" their obligations because futures contracts are relatively more expensive than the premiums received, and as noted before, the company had little capital above and beyond the premiums received. The company expected to make a profit on the theory few customers would exercise their options because they would have incorrectly guessed market

movements, and therefore enough money would be left from customer premiums to repay the few who exercised. Ultimately, when too many customers tried to exercise their options, the company defaulted on its obligations, went bankrupt and many customers were deprived of the benefit of their bargain. Hearings on H.R. 11955 before the House Committee on Agriculture, 93d Cong., 2d Sess., ser. 93-TT, at 181-182, 194-196 (1974); see also Hearings on S. 2485, S. 2578, S. 2837 and H.R. 131113 before the Senate Committee on Agriculture and Forestry, 93d. Cong., 2d Sess. pt. 1, at 224-225, pt. 3, at 682-683, 824-25, 830-835 (1974).

[10] House Committee on Agriculture Report on the Commodities Futures Trading Commission Act of 1974, H.R. Rep. No. 975, 93d Cong., 2d Sess. 36-37 (1974).

[11] Hearings on H.R. 11955 before the House Committee on Agriculture, 93d Cong., 2d Sess. at 37, 40-41, 176-180, 199, 251, 329 (1974); see Advisory Committee Report, p. 98.

[12] H.R. Rep. No. 975, 93d Cong., 2d Sess. 31 (1974).

[13] S. Rep, Bi, 1131m 93d Cong., 2d Sess. 26 (1974).

[14] H.R. Rep. No. 1383, 93d Cong., 2d Sess. 40 (1974). The (illegible) of the Joint Explanatory Statement of the Committee of (illegible) on this portion of the bill states:

> "(16) Options trading.
> The House bill continues the ban now contained in section 4c of the Act on trading in options (privileges, indemnities, bids, offers, puts, calls, advance guaranties, and decline guaranties) in the now-regulated commodities, but permits trading in options in all other commodities if not done contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or

allowing any such transaction under such terms and conditions as the Commission may prescribe. The Commission could promulgate such an order, rule, or regulation only after notice and opportunity for hearing. The Commission may set different terms and conditions for different markets.

The Senate amendment retains the House provision, but provides that the Commission is to prescribe the regulations governing such options trading within one year after the effective date of the bill.

The Conference substitute adopts the Senate provision with an amendment providing that the period for issuing regulations governing such options trading may be extended if the Commission determines, and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture, that it will be unable to promulgate such regulations within the one-year period."

[15] The Commission brought an injunctive action to restrain violations of these sections. *Commodities Futures Trading Commission v. J.S. Love & Associates Options, Ltd.*, (S.D.N. ., 1976) ¶ 20,198, CCH Comm. Fut. L. Rptr. Judge Bonsal denied injunctive relief because there was no likelihood the practices he found to be deceptive would be repeated. ee also *Commodities Futures Trading Commission v. British American Commodity Options Corp.* (S.D.N.Y. 1976) ¶ 20,224 CC Comm. Fut. L. Rptr., J. Gagliardi.

[16] John Rainbolt, the Vice-Chairman of the Commission was Chairman of the Advisory Committee and William Bagley, the Chairman of the Commission, was an ex-officio member of the Advisory Committee.

[17] For biographies of the members of this Advisory Committee, see the Advisory Committee Report, p. 174f.

[18] The Commission had not yet received the report of its Advisory Committee.

[19] See 41 Fed. Reg. at 7778 for further definition of the exclusions and inclusions to the net working capital requirement.

[20] Plaintiffs are agents for others who write options on two London exchanges. Plaintiffs have claimed that their principals are required to assume the full financial responsibility for the option transaction.

[21] By this statement the Commission may have meant that in these situations where an option dealer acts as an agent, whose only obligation is to transfer customer premiums to the option writer it might not be appropriate to require such agent to "segregate" the premium he was already obliged to transfer to another.

[22] The Commission also requested comments as to whether it should require option dealers to deliver disclosure statements to prospective customers in advance of any option transaction, and whether it should permit commodity options to be traded on contract exchanges and ultimately restrict option trading to such exchanges.

[23] Advisory Committee Report, p. xv-xvi. This report was transmitted to the Committee on July 6, 1976 and published as a special supplement to the CCH Commodity Futures Law Reporter on July 15, 1976.

[24] *Id.*, p. 18, 30, 47-48. The Advisory Committee recommended requiring dealers to segregate that portion of the customer's funds which represented the premium paid for the option right, leaving the dealer free to use that portion representing his costs and commission. It did not suggest specific percentages.

[25] *Id.*, pp. vi, xiii

"While it is not, and was not intended to be the 'ultimate' study on the subject (which must of necessity await more definitive data), its undertaking was suggested as an *initial* step in dealing with the issues posed by §4c(b) of the Commodities Exchange Act. *Id.*, p. vi . . .

"There are limits to be the use of the Advisory Committee forum itself, especially in an area as complex as commodity option trading, where the lack of needed data regarding the subject hampered the Advisory Committee's inquiries." *Id.*, p. xiii

[26] This proposed regulation provided that the option dealers who were required to register must segregate 100% of the funds received from customers. 41 Fed. Reg. at 44567.

[27] Thus, these Commission rules would require agent option dealers such as plaintiffs to keep the customer's funds segregated in the United States, thereby requiring them, in turn, to obtain additional funds to remit to London in order to obtain the option position.

In addition, we note that plaintiffs have claimed that their principals in turn, are required by the London exchanges of which they are members to segregate all customer premiums so that the agents' customers will be protected. The Commission has disputed this claim, citing the Advisory Committee Report, pp. 41-42, 130-139.

[28] See the memorandum of the National Association of Commodity Option Dealers in support of the complaint, Exhibit III, for excerpts of the minutes of the Commission's meeting at which the reduction from 100% to 90% was approved.

[29] Although the Commission appears to justify such haste by adverting to the Congressional directive in §4c(b) that it promulgate rules with respect to options within one year, we note that the Conference Committee amendment which was embodied in the final version of the bill provided an exception to this requirement if the Commission determines and notifies both Houses of Congress "that it is unable to prescribe such terms and conditions within such period." We further note that the Commission did promulgate one set of rules concerning option transactions, the antifraud rules, within the one year period. In addition, on October 8, 1976 the Commission stated: at 41 Fed. Reg. 44560, n.5:

> "Section 4c(b) also provides that, if possible, rules were to be adopted within one year after the effective date of the section. However, the Commission advised Congress, in accordance with the provisions of section 4c(b), that it would be unable to meet the one-year time period ending April 21, 1976, within which to have comprehensive commodity option regulations in effect and that additional time would be required to carry out the Congressional mandate contained in section 4c(b)." See 41 FR (illegible) (April 21, 1976)

[29a] The Commission's suggestion that this could be accomplished by bank financing is not persuasive.

[30] Amended Complaint ¶ 8b, p.4.

[31] The Commission stated:

> "The Commission finds that the public interest requires that the foregoing rules be adopted without any further delay inasmuch as the public has been without the protection of a comprehensive regulatory program in an area

which historically has been fraught with abuses. Moreover, there has been ample notice and public participation in this rule-making proceeding and affected persons have had adequate notice and opportunity to comment on the subject of these rules and the issues involved in their consideration, as well as the terms of the rules themselves substantially as adopted. Furthermore, affected persons have had an adequate opportunity, through prior notices, to take the necessary steps to be in full compliance with the rules by the effective dates thereof." 41 Fed. Reg. at 51817. See also 41 Fed. Reg. at 51810, column 1.

[32] In fact, most of the changes relieved prior proposed restrictions thus meeting the terms of another exception to 30-day publication, that stated in subsection (1) of §553(d).

[33] In addition, we note that §4c(b) of the Commodities Exchange Act does authorize the defendants to prohibit trading in options provided the defendants act by rule or order after notice and opportunity for hearing.

[34] Section 2(a)(1) of the Commodities Exchange Act, 7 U.S.C. §2. We note that the Commission has previously taken the position that other provisions of the Commodities Exchange Act which use the language "commodities for future delivery on or subject to the rules of a contract market", for example §4b, "may not apply to option transactions since these transactions are not made 'on or subject to the rules of any contract market.'" 40 Fed. Reg. 18188 (April 25, 1975).

APPENDIX D

§32.6 *Segregation.*

(a) Any person which accepts money, securities or property from an option customer as payment of the purchase price in connection with a commodity option transaction shall treat and deal with such money, securities and property as belonging to such option customer until expiration of the term of the option or, if the option customer exercises the option, until all rights of the option customer under the commodity option have been fulfilled. Such money, securities, and property (1) shall be separately accounted for and segregated as belonging to such option customer, (2) shall be kept in the United States, and (3) shall not be commingled with the money, securities and property of any other person, including the money, securities or property received by a futures commission merchant to margin, guarantee or secure the trades or contracts of commodity customers (as defined in §1.3(k) of this chapter) or with the money accruing to such commodity customers as the result of such trades or contracts: *Provided, however,* That the money, securities or property treated as belonging to an option customer may for convenience be commingled with the money, securities or property treated as belonging to any other option customer and deposited in the same account or accounts with any bank or trust company in the United States. Such money, securities and property, when so deposited with any bank or trust company, shall be deposited under an account name which will clearly show that it contains money, securities or property, segregated as required by this Part. Each person depositing such money, securities or property shall obtain and retain in its files for the period provided in §1.31 of this chapter an acknowledgement from such bank

or trust company that it was informed that the money, securities and property therein are being treated as belonging to option customers and are being held in accordance with the provisions of this Part. Such bank or trust company shall allow inspection of such accounts at any reasonable time by representatives of the Commission: *Provided, further,* That, up to a maximum of 10 percent of the money, securities or property accepted from an option customer as payment of the purchase price in connection with a commodity option transaction need not be treated and dealt with as belonging to the option customer and segregated as aforesaid.

(b) No money, securities or property deposited in accordance with paragraph (a) of this section shall be held, disposed of, used or treated as belonging to the depositing person or any person other than the option customers of such person: *Provided, however,* That such money may be invested in obligations of the United States, and in obligations fully guaranteed as to principal and interest by the United States. Such investments shall be made through an account or accounts used for the deposit of money, securities or property received from option customers and proceeds from any sale of such obligations shall be redeposited in such account or accounts. Each person which invests money belonging to option customers in obligations as described in this paragraph (b) ,shall separately account for such obligations and segregate such obligations as belonging to such option customers. Such obligations may only be deposited with a bank or trust company in the United States and shall be deposited under an account name which will clearly show that it contains obligations treated as belonging to option customers, segregated as required by this Part. Each person depositing such obligations shall obtain and retain in its files an acknowledgment from such bank or trust company that it was informed that the

obligations are treated as belonging to option customers and are being held in accordance with the provisions of this Part. Such acknowledgment shall be retained for the period provided in §1.31 of this chapter. Such bank or trust company shall allow inspection of the obligations at any reasonable time by representatives of the Commission.

(c) Each person which invests money treated as belonging to option customers as permitted hereunder shall keep a record showing the following: (1) the date on which such investments were made, (2) the name of the person through which such investments were made, (3) the amount of money sc invested, (4) a description of the obligations in which such investments were made, (5) the identity of the depositories or other places where such obligations are segregated, (6) the date on which such investments were liquidated or otherwise disposed of and the amount of money received on such disposition, if any, and (7) the name of the person to or through which such investments were disposed of.

(d) Persons which invest money in obligations described in paragraph (b) of this section shall include such obligations in segregated accounts at values which at no time shall be greater than current market value, determined as of the close of the market on the last preceding market day.

(e) The deposit and/or investment of money as provided in paragraphs (a) or (b) of this section shall not operate to prevent the person so depositing and/or investing such money from receiving and retaining as its own any increment or interest resulting therefrom.

(f) The amount of money, securities and property which is and which must be in a segregated account in

order to comply with the requirements of this Part shall be computed by each person required to segregate such money, securities and property as of the close of each business day. A record of such computation shall be made and kept, together with all supporting data in accordance with the provisions of §1.31 of this chapter. Such computation shall be made prior to the opening of business on the next business day.

§32.10 *Option transactions entered into prior to the effective date of this Part.*

Nothing contained in this Part shall be construed to affect any lawful activities that occurred prior to the effective date of this Part.

APPENDIX E

Section 4c(b) of the Commodity Exchange Act, 7 U.S.C. §6c(b) (Supp. V, 19)

§6c. *Wash sales; cross trades; fictitious sales; privileges; offers; puts; calls; guaranties.*

(b) No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this chapter, but not specifically set forth in section 2 of this title, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or

"decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: *Provided,* That any such order, rule, or regulation may be made only after notice and opportunity for hearing: *And provided further,* That the Commission may set different terms and conditions for different markets. (As amended Oct. 23, 1974, Pub. L. 93-463, title I, §103(a), title IV, §402, 88 Stat. 1392, 1412.)

APPENDIX F

Section 15 of the Commodity Exchange Act, 7 U.S.C. §19 (Supp. V, 1975)

§19. ***Antitrust laws; anticompetitive means.***

The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of this chapter, as well as the policies and purposes of this chapter, in issuing any order or adopting any Commission rule or regulation, or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 21 of this title. (Sept. 21, 1922, ch. 369, §15, as added Oct. 23, 1974, Pub. L. 93-463, title I, §107, 88 Stat 1395).

APPENDIX G

Section 10(e) of the Administrative Procedure Act, 5 U.S.C. §706 (1970)

§706. *Scope of review*

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall –

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be –

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law:

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error. Pub. L. 89-554, Sept. 6, 1966, 80 Stat. 393.

APPENDIX H

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA ATLANTA DIVISION

C77-643A

ORDER OF COURT

This is an action for injunctive and declaratory relief brought by Frankland Commodities Corporation (Frankland) against the Commodity Futures Trading Commission (CFTC) and the five individual Commissioners of the CFTC. Jurisdiction is founded upon 28 U.S.C. §§1344(a)(2), 2201 and 2202 and the Administrative Procedure Act, 5 U.S.C. §§551 and 553. Frankland seeks to enjoin the enforcement of the segregation requirements contained in 17 C.F.R. §32.6. Frankland also seeks a declaratory judgment on the grounds that the segregation provision is null and void on the basis that it is arbitrary, capricious, anticompetitive, void for vagueness, contrary to public policy and that it will deprive plaintiff of its property without due process of law.

The Court, having heard oral argument on May 5, 1976, presently has before it Frankland's motion for a preliminary injunction.

On October 23, 1974, Congress enacted the Commodity Futures Trading Commission Act of 1974 (Act), Pub. L. 93-463, 88 Stat. 1389, which established the CFTC as an independent regulatory agency of the United States charged with the responsibility for enforcing and administering the provisions of the Act.

The commodities business involves the trading of contracts for the purchase or sale of specific amounts of a commodity either that have already been produced, or that will be produced in the future and delivered by a specific date. The latter group of contracts are known as "commodity futures" and are freely traded in the commodities marketplace. A "commodity option" is a contractual right to buy or sell a commodity or commodity future by some specific date at a specified price. Generally, an option is created, or "written," by the owner, or "grantor," of a commodity or commodity futures contract, who obligates himself to sell his goods or contract.

Frankland does not engage in the sale of commodities or commodity futures, but rather, deals only in options on futures contracts for certain commodities that are traded in London, England. Frankland solicits customers for London options only in the United States. Once Frankland obtains an order for an option, Frankland requires that its customer pay Frankland in full for the retail value of the option. According to plaintiff, when Frankland receives the customer's money it purchases the option from a trader on the London Option Market. Frankland's cost for its options is approximately 72 percent of the amount it receives from its customers, the remaining 28 percent becoming profit.

The London Option Market is composed of members of the International Commodity Clearing House (ICCH) and the London Metal Exchange (LME). After execution of the option the grantor is required to escrow or segregate 100 percent of the price of the option in special accounts with the ICCH which guarantees fulfillment of each futures option executed by its members.

In October 1975, the CFTC announced that it was considering rules to regulate or prohibit all options trading under the authority granted to it under the Commodity Futures Trading Commission Act, 7 U.S.C. §12a(5) (Supp. V., 1975), and invited public comment. 40 Fed. Reg. 49360-49362 (October 22, 1975). On February 20, 1976, the CFTC published proposed temporary rules to govern commodity options transactions. 41 Fed. Reg. 7774-7776 (February 20, 1976). These proposed temporary regulations did not include a requirement that the United States option dealer escrow or segregate any portion of the customer's cash payment until the option is sold or exercised. However, the CFTC did indicate its interest in comments on such a requirement. 41 Fed. Reg. 7776 (February 20, 1976).

On October 8, 1976, the CFTC published proposed interim regulations, which included a segregation requirement, and invited public comment. 41 Fed. Reg. 44560, 44561, 44567 (October 8, 1976). The CFTC adopted these regulations, substantially in the same form as proposed, and gave public notice on November 24, 1976. 41 Fed. Reg. 51808-51810, 51815-51816 (November 24, 1976). The effectiveness of the segregation requirement was delayed 30 days.

Section 32.6 of these regulations requires a futures commission merchant, such as Frankland, to segregate 90 percent of the payment received from the customer in a

United States bank account until expiration or exercise of the option. But the London exchanges must simultaneously be sent that portion of the customer's money that represents the wholesale price of the option. Frankland, therefore, must itself have the funds to place a major portion of the price of the option it sells in a segregated account in the United States. Frankland contends that this "double segregation" burden will require it to raise approximately 189,000 dollars per month, which may be impossible for it to raise. See Affidavits of C. Jeffery Jacobs and Don F. Barnes (filed May 5, 1977). Plaintiff claims that the segregation regulation is anticompetitive inthat it will force small futures commission merchants out of business and allow only the large houses, with substantial capital bases, to remain operating. Frankland further contends that the segregation requirement is not needed to protect American investors inasmuch as the London market has its own system of customer safeguards.

The Second Circuit, in *British American Commodity Options Corp., et al v. Bagley, et al.*, Civil Action Nos. 77-6010, 77-6011, 77-6019 (April 4, 1977), has upheld the segregation requirement under attack in the instant action, and the plaintiffs in that case have filed petitions for rehearing. The Second Circuit seriously questioned the protection afforded United States customers by the London safeguards and found that the segregation requirement was a reasonable exercise of the CFTC's discretion in an effort to protect the public from the abuses that have plagued the commodity options industry.

In weighing any request for preliminary injunction, this Court must be guided by the standards set forth by the United States Court of Appeals for the Fifth Circuit in *Canal Authority of State of Florida v. Callaway*, 489 F.2d 567 (1974). The Court of Appeals there noted that,

although the granting of a preliminary injunction is discretionary, the district court must exercise that discretion in the light of four prerequisites:

> "The four prerequisites are as follows: (1) a substantial likelihood that plaintiff will prevail on the merits, (2) a substantial threat that plaintiff will suffer irreparable injury if the injunction is not granted, (3) that the threatened injury to plaintiff outweighs the threatened harm the injunction may do to defendant, and (4) that granting the preliminary injunction will not disserve the public interest." (citation omitted)

489 F.2d at 572.

The Court of Appeals has also stressed the extraordinary character of such relief:

> "In considering these four prerequisites, the court must remember that a preliminary injunction is an extraordinary and drastic remedy which should not be granted unless the movant clearly carries the burden of persuasion. The primary justification for applying this remedy is to preserve the court's ability to render a meaningful decision on the merits." *Id.* (citation omitted)

Those standards are set forth in recognition of the fact that the district court must decide whether to grant the interim relief of a preliminary injunction without the benefit of full discovery and consideration of the issues on the merits that would occur at trial.

The Court is not entirely persuaded by the decision of the Second Circuit and, therefore, is not of the opinion that plaintiff has not presented a substantial cause of action. The Court does find, however, that Frankland has not presented

the Court with sufficient evidentiary documentation of the irreparable injury that will be caused by the enforcement of the segregation regulation and, therefore, finds that Frankland has failed to carry its burden of persuasion, as required by the Fifth Circuit, regarding the threat of irreparable injury. Accordingly, plaintiff's motion for a preliminary injunction is hereby DENIED.

SO ORDERED, this 12 day of May, 1977.

/s/ Charles A. Maye, Jr.
United States District Judge

APPENDIX I

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA ATLANTA DIVISION

Civil Action File No. 77–643A

ORDER GRANTING INJUNCTION PENDING APPEAL

This cause came on to be further heard on motion of plaintiff for an injunction pending appeal, and it appearing to the Court that the relief herein granted is necessary to preserve the status quo pending appeal by the plaintiff to the U.S. Court of Appeals for the Fifth Circuit for the reason that irreparable damage will result to the plaintiff pending such appeal if the denial of plaintiff's motion for preliminary injunction shall be reversed on appeal,

IT IS ORDERED that provided Notice of Appeal is filed by May 17, 1977 and prosecuted diligently and expeditously thereafter until a hearing and determination of the appeal herein to the U.S. Court of Appeals for the Fifth Circuit, the defendants be and hereby are restrained from enforcing their Rule 32.6 (17 CFR §32.6) as to plaintiff, and that the security in the amount of $25,000.00 deposited with the Clerk of the Court by plaintiff as a condition of the temporary restraining order issued in this action shall continue to be deposited with the Court as security for this injunction pending appeal conditioned upon the faithful performance by plaintiff of its obligations to its customers.

IT IS SO ORDERED this 12 day of May, 1977.

/s/ Charles A. Moye, Jr.
Judge
United States District Court,
Northern District of Georgia

APPENDIX J

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

77 Civ. 3048 MP

PRELIMINARY INJUNCTION

Plaintiff Neuberger Securities Corporation ("Neuberger") having moved this Court by order to show cause dated June 22, 1977 for an order pursuant to Rule 65 of the Federal

Rules of Civil Procedure for an order preliminarily enjoining the defendants from enforcing Regulation 17 C.F.R. §32.6 (1976), as to plaintiff Neuberger, pending the final disposition by the United States Supreme Court of the case of *British American Commodity Options Corp. v. Bagley*, (2d Cir. # 77-6010, S.D.N.Y. 76 Civ. 5124 (WK)) and until such time as such regulation is equally enforced against all commodity option dealers and said order to show cause having come on to be heard before me in Room 506 (Part I) United States District Court, Southern District of New York and after hearing Gerald D. Fischer of Lefrak Fischer Myerson & Mandell on behalf of plaintiff Neuberger in support of the order to show cause and Virginia F. Crisman of the office of General Counsel of the Commodity Futures Trading Commission in opposition to the order to show cause and upon the affidavit of Richard Neuberger and Carol Aronoff submitted in support of the order to show cause and the Court having made its oral findings of fact and conclusions of law persuant to Rule 65 F.R. Civ. P. as set forth in transcript of hearing June 28, 1977

ORDERED that defendants are preliminarily enjoined, pending further order of this Court, from requiring plaintiff Neuberger to comply with REgulation 17 C.F.R., Section 32.6, the so-called "double segregation" rules, as to all commodity options transactions entered into by Neuberger after the date of this order and it is further

ORDERED that as to all commodity option transactions entered into by plaintiff Neuberger prior to the date of this order, for which funds in excess of $250,000 have been segregated in accordance with Regulation 17 C.F.R. Section 32.6, said transactions and segregated funds are not to be affected by this actions shall not (illegible) Section 32.6 and it is further

ORDERED as to all commodity option transactions covered by 17 C.F.R. Section 32.6, and entered into by plaintiff Neuberger after the date hereof and while this preliminary injunction is in effect, plaintiff Neuberger shall give notice in writing to its customers, at or prior to the consummation of the transaction that plaintiff Neuberger, under claim of right and in connection with this litigation, has refused and does not intend to segregate funds under 17 C.F.R. Section 32.6 and that any risk resulting from a failure to comply with said regulation is a matter for the customer to consider and it is further

ORDERED, that as a term and condition of this preliminary injunction, plaintiff is required to file and has filed the attached letter of credit in the principal amount of $100,000 to secure any damages resulting to plaintiff's customers by reason of plaintiff's failure to comply with 17 C.F.R. 32.6 during the period when this order is in effect and it is further

ORDERED that this preliminary injunction shall terminate (a) upon the issuance, after notice and hearing, of an order vacating the same, by District Judge Milton Pollack, the judge assigned to this case, or (b) upon the issuance of the mandate of the Court of Appeals of the Second Circuit in the *British American* case and the vacating of the preliminary injunction issued by District Judge Knapp as to all parties in that case and it is further

ORDERED that, unless otherwise directed by District Judge Pollack, if and when the mandate issues from the Court of Appeals in the *British American* case to this Court for further proceedings then the parties must apply for

consolidation or such other procedure as will permit the issues presented here to be disposed of concurrently with the issues presented in the *British American* case.

Dated: July 7, 1966

/s/ Charles L. Brieant
U.S.D.J.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

NO. 77-204

NATIONAL ASSOCIATION OF COMMODITY OPTION DEALERS, a non-profit association, HOFMANN, KAVANAUGH COMMODITIES CORP., INC., as Successor In Interest to First Western Commodity Options, Inc. of Los Angeles, A. L. & T. TRADING, INC., CHARTERED SYSTEMS CORPORATION, CLEARY TRADING COMPANY, INC., FIRST COMMODITIES CORP. OF BOSTON, INC., INTERNATIONAL TRADING GROUP, LTD., LONDON FUTURES, LTD., AND WILLISTON CORPORATION,

Petitioners,

v.

THE COMMODITY FUTURES TRADING COMMISSION, WILLIAM T. BAGLEY, Chairman; COMMODITY FUTURES TRADING COMMISSION, JOHN B. RAINBOLT, II, Vice Chairman; COMMODITY FUTURES TRADING COMMISSION, GARY SEEVERS, Commissoner; COMMODITY FUTURES TRADING COMMISSION, READ P. DUNN, JR., Commissioner; COMMODITY FUTURES TRADING COMMISSION; and ROBERT L. MARTIN, Commissioner, COMMODITY FUTURES TRADING COMMISSION,

Respondents,

REPLY TO BRIEF FOR RESPONDENTS IN OPPOSITION

GOLDSTEIN, AHALT & BENNETT,
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Respondents,

REPLY TO BRIEF FOR RESPONDENTS IN OPPOSITION

Now come the petitioners National Association of Commodity Options Dealers ("NASCOD"), and certain members firms thereof, hereinafter sometimes collectively known as

"Petitioners", and hereby reply to the Brief For Respondents in Opposition ("Opposition Brief") filed on behalf of the respondents Commodity Futures Trading Commission and individual members thereof ("Commission"). The Opposition Brief fails to demonstrate that this Honorable Court should not issue a writ of certiorari to the United States Court of Appeals for the Second Circuit ("Court of Appeals") to review the Judgment and Opinion entered in this action on April 4, 1977, as to the reversal of the preliminary injunction and the premature grant of summary judgment on the issue of the lawfulness of Commission Regulation 32.6, 17 C.F.R. 32.6 (1976), and does not refute the careful argumentation set forth in the original Petition for a Writ of Certiorari ("Petition"), filed on August 5, 1977.

The Commission commences its argument by stating that the decision "did not create any conflict among the Courts of Appeals" (Opposition Brief, p. 10). This statement is accurate in that the decision at issue here is the first review by any Court of Appeals of the regulations promulgated by the new Commission, but is completely irrelevant to the case at bar. It is clear, as the Opposition Brief states, that a number of United States District Courts have enjoined the enforcement of the Regulation (Fn 5, pp. 9-10). These Courts are located in four (4) different Circuits; the Fifth Circuit (*Frankland Commodities Corp. v. Commodity Futures Trading Commission*, N.D.Ga., No. C-77-643 A); the Second Circuit (*Dorchester Commodities Corp. v. Commodity Futures Trading Commission*, S.D.N.Y., 77 Civ. No. 3958 (two firms); *Neuberger Securities Corp. v. Commodity Futures Trading Commission*, S.D.N.Y., 77 Civ. No. 3048; *Transocean Commodity, Ltd. v. Commodity Futures Trading Commission*, S.D.N.Y., 77 Civ. No. 4060); the Tenth Circuit (*London Commodity Options, Ltd., v. United States,*

D.Utah No. C-77-0293), and the District of Columbia Circuit (*Murlas Brothers Commodities, Inc., v. Commodity Futures Trading Commission*, No. C.A. 77-1473). These injunctions have all been issued since the decision by the Court of Appeals. This multiplicity of subsequent decisions adverse to the Commission calls the decision of the Court of Appeals into question, and indicates that the lawfulness of "double segregation" is an important federal matter, which this Honorable Court should resolve. *See, Shapiro v. United States*, 335 U.S. 1, 4 (1974).

The Opposition Brief argues that this Honorable Court should not grant review in that "routine Commission inspections of fourteen of the approximately sixty firms selling options have established that twelve of these fourteen were complying substantially with the regulations," and that therefore "double segregation" may not have the deleterious effect claimed by Petitioner. (Opposition Brief, p. 10-11). This statement is an attempt to introduce unverified factual material into this proceeding long after the closing of the record. Furthermore, these factual allegations have not been tested in the crucible of litigation, so Petitioners do not know the nature of these inspections, or are even certain of the identity of the twelve firms.

Although the Opposition Brief does not identify the "twelve of the fourteen" inspected firms who are supposedly in compliance with double segregation, they are probably the same 12 of the other firms complying with double segregation indicated in Footnote 7, page 7, of the Commission's Motion to Vacate Stay of the Mandate filed with Mr. Justice Marshall. Of those dozen listed firms, Clayton Brokerage Co. of St. Louis, Ltd., International Precious Metals Corp., Madda Trading Co., Shearson Hayden Stone, Inc., and Siegel Trading Co. Inc., are

diversified wire houses or firms which do not do a significant part of their business in retail sales of London options. Crown Colony Options, Ltd., has since been absorbed by Neuberger Securities Corp., and accordingly, now enjoys court protection. *Neuberger Securities Corp. v. Commodity Futures Trading Commission, supra.* Both London Commodity Options, Ltd., and United Kingdom Commodity Options, Ltd., have obtained their own preliminary injunctions against having to double segregate further. *Dorchester Commodities Corp. and United Kingdom Commodity Options, Ltd., v. Commodity Futures Trading Commission, et al., supra, London Commodity Options v. United States, supra.*

Rothschild Commodities, Inc., had originally obtained court protection by intervening in *Frankland Commodities Corp. v. Commodity Futures Trading Commission, supra.* Thereafter, Rothschild withdrew from the action and was absorbed by Rosenthal & Co., another firm the Commission lists as being substantially in compliance with double segregation. Rosenthal & Co. in turn is the subject of both a massive civil injunctive anti-fraud action and an administrative proceeding brought by the Commission. *Commodity Futures Trading Commission v. Rosenthal & Co.*, (N.D. ILL. Civil Action No. 76-C-3904); *Commodity Futures Trading Commission v. Rosenthal & Co.*, CFTC Docket No. 77-10. Certainly therefore, this selection of firms does not indicate that an ethical options specialty firm can survive double segregation. Rather, it strongly indicates the contrary.

Moreover, even the Commission in the October 8, 1976, Federal Register Notice admitted that the Regulation would impose a "financial hardship on affected firms". 41 Fed. Reg. 44562. Mr. Justice Marshall in rejecting the application of the

Commission to dissolve the stays of the mandate in this proceeding specifically noted:

> "If and when the Regulation does go into effect, respondents may well be driven out of business, and on this basis the District Court expressly found that respondents are threatened with irreparable harm" *C.F.T.C. v. British American Commodity Options Corp.,* CCH Com. Fut. L. Rep. P. 20, 458, page 21, 888.

The Opposition Brief characterizes the double segregation requirement as a "temporary" measure, and states that "review by this Court of the present case would be premature" (p. 13). This Honorable Court should not deny certiorari on the basis of the Commission's representation that Regulation 32.6 may be repealed at some unspecified later date. The Regulation was originally due to become effective on December 27, 1976, over ten (10) months ago, and the Commission is under no obligation whatsoever to repeal or revise it. The Commission stated that it would "shortly propose" second phase regulations as early as the October 8, 1976, Federal Register Notice which first set forth the "double segregation" requirement. 41 Fed. Reg. 44561. Although, as the Opposition Brief states, proposed new Regulations for options trading were published on April 5, 1977, 42 Fed. Reg. 18246, the latest set of such proposed regulations were not published in the Federal Register until October 17, 1977. 42 Fed. Reg. 55538 *et seq.,* and these are substantially different from the earlier proposed regulations. This latest set of proposed options regulations are subject to comments until December 1, 1977, and no proposed effective date has even been set. 42 Fed. Reg. 55538.

Moreover, there is no indication that new regulations will ever be adopted in the proposed form, or otherwise. In fact, at

the Commission's hearing on the proposed regulation (which has not been transcribed to Petitioner's knowledge) several of the Commissioners had grave doubts as to the legal effic cy of the proposed regulations, but voted for their publication for the purpose of eliciting industry comment. There is still no indication when – or if – superseding regulations will be effective "double segregation" repealed.

Moreover, the fact that the Regulation may not be intended as a permanent fixture should not preclude review. Any agency has the right to change any of its regulations at any time. Any agency could escape judicial review of its regulations by merely claiming that at some point it will promulgate superceding rules. At some point, an agency's characterizing its regulations as "interim" should be construed as a misleading label. In view of the actual longevity of the Regulation, its inarguable harshness, and the multiple contested litigation it has engendered, it is disingenuous in the least for the Commission to claim that judicial review of this Regulation by this Honorable Court is "premature" at this juncture.

The Commission next alleges that the segregation imposed by Regulation 32.6 17 C.F.R. 32.6 (1976) is neither novel nor unusual, but rather analogous to the segregation of a futures customer's funds received by a firm to margin, guarantee or secure the trades or contracts of such customer in special accounts as required by Section 4d(2) of the Commodities Exchange Act, as amended ("The Act"), 7 U.S.C. 6d(2) (Supp. V (1975)). However, the Commission was well aware, at the time, in promulgating the original regulation 32.6, that it imposed a requirement which went far beyond the traditional limited segregation:

> "As noted above, the Commission is aware that proposed Section 32.6 may in certain cases, require 'double segregation'. For example, in the case of the sale of London Options, a person receiving the funds from an option customer in the United States as payment for the option may not remit those funds to London in order to obtain or maintain the option position with the London broker." 41 Fed. Reg. 44562.

Mr. Justice Marshall also explained that Regulation 32.6 was a significant departure from the earlier procedure.

> "... It does appear that the Regulation would fundamentally alter the ground rules for doing business in a substantial industry, with potentially fatal consequences for a number of the firms currently in the trade, and this case presents the first opportunity for this Court to pass on action taken by the recently created Commission." *C.F.T.C. v. British Commodity Options Corp., supra,* P. 21,889.

The Commission next states that options firms should be able to survive double segregation by borrowing the funds required to purchase the options. (p. 14-16). This argument by the Commission ignores the reality that a financial institution will not lend the vast amounts of money necessary to finance double segregation, as the Commission has taken the position that segregated funds are not collateralizable, and the Regulation is not clear when such funds can be released. *See, Murlas Brothers Commodities, Inc., v. C.F.T.C., supra,* CCH Com. Fut. L. Rep. P. 20,483, pp. 21, 968-69. The District Court in this case specifically found that the Commission suggestion that double segregation could be "accomplished by bank

financing is not persuasive," (Petition p. A. 49.), and no evidence to rebut this finding has ever been entered in the record of this proceeding in that the Commission has never been able to show even one firm that can meet the burden of double segregation through bank financing.

The Opposition Brief next argues that a customer might well have a claim to segregated funds in the event of an options firm's insolvency, and that therefore the double segregation requirement could accomplish its stated purpose (Opposition Brief p. 19-20). However, there is no indication that the Commission has sought and obtained "the appropriate legislation to assure that full recognition be given under the Bankruptcy Laws to assets segregated for the benefit of customers", as the July Advisory Committee Report recommended (*See*, Petition, p. 27). The Commission states that it is within its "broad authority under Section 4c(b) [of the Act] to impose this condition upon options trading, and the Courts should respect the legal relationships it establishes." (p. 19). However, this conclusory statement does not change the fact that the Commission does not have the authority to amend the Bankruptcy Act through the promulgation of regulations. Secured and general creditors would have first claim to the segregated funds in that these monies would constitute the fees and commissions earned by the dealer at the time the option was sold and would also constitute a part of the merchant's working capital, since the wholesale cost of the option would have been paid to the London Exchanges at the time the option was written. As the customer would have already received value for money in the form of the option, the actual funds segregated then would be the property of the option dealer, and not the customer. As such, a Trustee in Bankruptcy would be vested with title to the segregated

funds for the benefit of all creditors, and no preference on the part of a customer would be recognized in the absence of corrective legislation.

In a situation involving the failure of a commodity options dealer, which was in a large part the impetus for the Commodity Futures Trading Commission Act, the Commission filed an *amicus* brief in the bankruptcy proceeding and acknowledged that no cases had been found applying general trust principles to situations involving commodity options, or profits earned thereon. *In Re J.S. Love & Associates Options, Ltd.*, Bankruptcy No. 76 B-590 S.D.N.Y. 1976). Neither *In the Matter of Weiss Securities Inc.*, CCH Com. Fut. L. Rep. P. 20,108 (S.D.N.1, 1975), nor *Seligson v. New York Produce Exchange*, CCH Com. Fut. L. Rep. P. 20,029 (S.D.N.Y. 1975), cited by the Commission in support of its contention that a bankrupt Futures Commission Merchant will be treated as a trustee of segregated customers' funds supports that proposition in any respect, nor do these cases hold that options customers would receive a preference as to the segregated funds. *Seligson v. New York Produce Exchange, supra,* dealt with the entirely irrelevant matters of whether payments of variation margin by a clearing member to a clearing association may be voided as fraudulent transfers by a trustee in bankruptcy, or whether an exchange could be held accountable for actions of a clearing association in receiving such alleged fraudulent transfers of variation margin. *In the Matter of Weiss Securities, supra,* is similarly in apposite, in that that case did not involve the purchase and sale of London options, but rather the dissolution of a diversified securities firm. The Court in that case noted that the policy of the Bankruptcy Act runs counter to the

creation of priority classes, and that certain claimants who had regulated commodities accounts were merely general creditors of the estate.

The Commission cites the bankruptcies of two (2) recent option firms, *In the Matter of Sterling Industries, Inc.*, N.D.Ill. No. 77 B 4431, and *In the Matter of Palmer Trading Co., Inc.*, E.D. Ill. No. 77 B 5157, for the proposition that "financially unstable firms pose substantial risks for investors" (p. 17). However, Sterling Industries, Inc., was never a duly registered Futures Commission Merchant, and therefore never subject to the full panoply of Commission Regulation, unlike Petitioner member firms. Furthermore, Palmer Trading Co., Inc., has filed for an arrangement proceeding pursuant to Chapter XI of the Bankruptcy Act, and specifically stated in its Petition for An Arrangement that it was not insolvent. More importantly, the fact that two options firms might have had financial difficulties certainly does not prove that the customers of either firm would have been aided in any respect by the imposition of double segregation upon such firms. Finally, the Commission has stated in the Opposition Brief, that there are sixty (60) Futures Commission Merchants duly registered to sell options (p. 11). Palmer Trading Co., Inc., is the only one of those sixty which the Commission can cite as having been involved in an insolvency proceeding since the commencement of the litigation.

The Opposition Brief further states that the Commission fulfilled the duties imposed upon it pursuant to Section 15 of the Act, 7 U.S.C. 19 (Supp. V, 1975) in considering the anticompetitive implications of the double

segregation rule, and in endeavoring to take the least anticompetitive means. However, the Commission does not support this statement, other than to again recite its conclusory discussion of the anticompetitive aspects of the rules which it has published at 41 Fed. Reg. 51809. Considering Section 15 in *Murlas Brothers Commodities, Inc. v. C.F.T.C., supra,* Judge Barrington Parker of the United States District Court for the District of Columbia stated:

> "However, there can be no question that Regulation 32.6 will tend to restrict participation in the Commodity Option business to a few large firms. While the Commission apparently has the power to restrict participation in options to those firms with sufficient capitalization, such actions must be taken with cognizance of the antitrust policy of Section 19. Since other Commission regulations insure adequate capitalization of registered options dealers, the Regulation may be invalid under that Section." CCH Com. Fut. L. Rep. P. 21.969.

Finally, the Opposition Brief states that petitioners' "Central assault on the segregation requirement" is based upon the premise that customers are already adequately protected by guarantees of performance in the London Exchanges (p. 20). This simplistic statement, however, is a complete mischaracterization of the scope and depth of petitioners' challenge to Regulation 32.6. Petitioners have cited the guarantees on the London Exchanges and their unparalleled record of over a century of complete safety only to rebut the contention by the Commission that "double segregation" is necessary to protect American customers from unnamed dangers on those exchanges. *See*, 41 Fed. Reg. 44564 (1976); Petition p. 25). This contention is unrefuted in the Opposition Brief.

Therefore, the Opposition Brief states no reason whatsoever why this Honorable Court should not issue a writ of certiorari forthwith to decide once and for all the issue of the lawfulness of a novel, unprecedented regulation, which is continuing to trouble the Courts.

CONCLUSION

For the foregoing reasons, as well as those urged in the Petition, a writ of Certiorari should issue.

Respectfully submitted,

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